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# Legislative Proposals and Explanatory Notes Relating to Income Tax

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Published by  
The Honourable Paul Martin, P.C., M.P.  
Minister of Finance

September 1999

Canada



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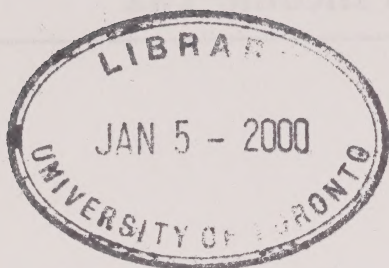
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## PART 1

## INCOME TAX ACT

1. (1) Subsection 20(1) of the *Income Tax Act* is amended by striking out the word “and” at the end of paragraph (uu), by adding the word “and” at the end of paragraph (vv) and by adding the following after paragraph (vv): 5

**Split income**

(ww) where the taxpayer is a specified individual in relation to the year, the individual’s split income for the year.

(2) Subsection (1) applies to the 2000 and subsequent taxation years. 10

2. (1) Section 56 of the Act is amended by adding the following after subsection (4.3):

**Exception for split income**

15

(5) Subsections (2), (4) and (4.1) do not apply to any amount that is included in computing a specified individual’s split income for a taxation year.

(2) Subsection (1) applies to the 2000 and subsequent taxation years. 20

3. (1) The portion of paragraph 60(I) of the Act before subparagraph (i) is replaced by the following:

**Transfer of refund of premiums under RRSP**

25

(I) the total of all amounts each of which is an amount paid by or on behalf of the taxpayer in the year or within 60 days after the end of the year (or within such longer period after the end of the year as is acceptable to the Minister)

(2) Subsection (1) applies to the 1999 and subsequent taxation years and, where an amount is included in computing a taxpayer’s income for a taxation year as a result of an election under subsection 32(4) of this Act, paragraph 60(I) of the *Income Tax Act* 30

shall apply to the taxpayer for the year and each subsequent taxation year that ends before 1999 as if

(a) the words “in the year or within 60 days after the end of the year” in that paragraph were read as “in the period that begins at the beginning of the year and ends on February 29, 2000 or on such later day as is acceptable to the Minister”; and 5

(b) subparagraph 60(l)(iv) of the Act were read as follows:

(iv) is designated in prescribed form filed with the Minister before May 2000 (or before such later day as is acceptable to the Minister), 10

4. (1) The description of C in section 61.2 of the Act is replaced by the following:

C is the greater of \$40,000 and the individual’s income for the year, determined without reference to this section, paragraph 20(1)(ww), section 56.2, paragraph 60(w), subsection 80(13) and paragraph 80(15)(a). 15

(2) Subsection (1) applies to the 2000 and subsequent taxation years.

5. (1) Paragraph (b) of the definition “eligible child” in subsection 63(3) of the Act is replaced by the following: 20

(b) a child dependent on the taxpayer or the taxpayer’s spouse for support and whose income for the year does not exceed the amount used under paragraph (c) of the description of B in subsection 118(1) for the year

(2) Subsection (1) applies to the 1999 and subsequent taxation years except that, in its application to the 1999 taxation year, the reference to “the amount used under paragraph (c) of the description of B in subsection 118(1) for the year” in paragraph (b) of the definition of “eligible child” in subsection 63(3) of the Act, as enacted by subsection (1), shall be read as a reference to “\$7,044”. 30

6. (1) Subsection 74.4(2) of the Act is amended by striking out the word “and” at the end of paragraph (e), by adding the word “and” at the end of paragraph (f) and by adding the following after paragraph (f):

(g) where the designated person is a specified individual in relation to the year, the amount required to be included in computing the 35

designated person's income for the year in respect of all taxable dividends received by the designated person that

(i) can reasonably be considered to be part of the benefit sought to be conferred, and

(ii) are included in computing the designated person's split income for any taxation year.

**(2) Subsection (1) applies to the 2000 and subsequent taxation years.**

**7. (1) Section 74.5 of the Act is amended by adding the following after subsection (12):**

**Exception from  
attribution rules**

(13) Subsections 74.1(1) and (2), 74.3(1) and 75(2) of this Act and section 74 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952, do not apply to any amount that is included in computing a specified individual's split income for a taxation year.

**(2) Subsection (1) applies to the 2000 and subsequent taxation years.**

**8. (1) Subsection 81(1) of the Act is amended by adding the following after paragraph (g.2):**

**Hepatitis C trust**

(g.3) the amount that, but for this paragraph, would be the income of the taxpayer for the year where

(i) the taxpayer is the trust established under the 1986-1990 Hepatitis C Settlement Agreement entered into by Her Majesty in right of Canada and Her Majesty in right of each of the provinces, and

(ii) the only contributions made to the trust before the end of the year are those provided for under the Agreement;

**(2) Subsection (1) applies to the 1999 and subsequent taxation years.**

**9. (1) Clause (a)(ii)(B) of the definition "preferred beneficiary" in subsection 108(1) of the Act is replaced by the following:**



(B) whose income (computed without reference to subsection 104(14)) for the beneficiary's year does not exceed the amount used under paragraph (c) of the description of B in subsection 118(1) for the year, and

(2) The portion of subsection 108(5) of the Act after paragraph (b) is replaced by the following:

but, for greater certainty, nothing in this subsection shall affect the application of subsection 56(4.1), sections 74.1 to 75 and 120.4 and subsection 160(1.2) of this Act and section 74 of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952.

(3) Subsection (1) applies to the 1998 and subsequent taxation years, except that the reference to "the amount used under paragraph (c) of the description of B in subsection 118(1) for the year" in clause (a)(ii)(B) of the definition "preferred beneficiary" in subsection 108(1) of the Act, as enacted by subsection (1), shall be read as a reference to

(a) "\$6,956" for the 1998 taxation year, and

(b) "\$7,044" for the 1999 taxation year.

(4) Subsection (2) applies to the 2000 and subsequent taxation years.

10. (1) The Act is amended by adding the following after section 110.1:

### *Lump-sum Payments*

#### Definitions

110.2 (1) The definitions in this subsection apply in this section and section 120.31.

"eligible taxation year"

« année d'imposition admissible »

"eligible taxation year", in respect of a qualifying amount received by an individual, means a taxation year

(a) that ended after 1977 and before the year in which the individual received the qualifying amount;

(b) throughout which the individual was resident in Canada;

(c) that did not end in a calendar year in which the individual became a bankrupt; and

(d) that was not included in an averaging period, within the meaning assigned by section 119 (as it read in its application to the 1987 taxation year), pursuant to an election that was made, and not revoked, by the individual under that section.

#### **“qualifying amount”**

« *montant  
admissible* »

“qualifying amount” received by an individual in a taxation year means an amount (other than the portion of the amount that can reasonably be considered to be received as, on account of, in lieu of payment of or in satisfaction of, interest) that is included in computing the individual’s income for the year and is

(a) an amount

(i) that is received pursuant to an order or judgment of a competent tribunal, an arbitration award or a contract by which the payor and the individual terminate a legal proceeding, and

(ii) that is

(A) included in computing the individual’s income from an office or employment, or

(B) received as, on account of, in lieu of payment of or in satisfaction of, damages in respect of the individual’s loss of an office or employment,

(b) a superannuation or pension benefit (other than a benefit referred to in clause 56(1)(a)(i)(B)) received on account of, in lieu of payment of or in satisfaction of, a series of periodic payments (other than payments that would have otherwise been made in the year or in a subsequent taxation year),

(c) an amount described in paragraph 6(1)(f), subparagraph 56(1)(a)(iv) or paragraph 56(1)(b), or

(d) a prescribed amount or benefit,

except to the extent that the individual may deduct for the year an amount under paragraph 60(n), (o.1), (v.1) or (w) or 110(1)(f) in respect of the amount so included.

**“specified portion”**

5

**« partie déterminée »**

“specified portion”, in relation to an eligible taxation year, of a qualifying amount received by an individual means the portion of the qualifying amount that relates to the year, to the extent that the individual’s eligibility to receive the portion existed in the year.

**Deduction for lump-sum payments**

15

(2) There may be deducted in computing the taxable income of an individual (other than a trust) for a particular taxation year the total of all amounts each of which is a specified portion of a qualifying amount received by the individual in the particular year, if that total is \$3,000 or more.

20

(2) Subsection (1) applies to amounts received by an individual after 1994 (other than an amount in respect of which tax has been remitted to the individual under subsection 23(2) of the *Financial Administration Act*) and, notwithstanding subsections 152(4) to (5) of the *Income Tax Act*, any assessment of the individual’s tax payable under that Act for any taxation year that ended before 1999 shall be made as is necessary to take into account the application of subsection (1).

25

**11. (1) Section 110.4 of the Act is repealed.**

(2) Subsection (1) applies to the 1998 and subsequent taxation years.

30

**12. (1) The formula set out in the definition “farm loss” in subsection 111(8) of the Act is replaced by the following:**

**A - C**

(2) The definition “farm loss” in subsection 111(8) of the Act is amended by adding the word “and” at the end of the description of A and by repealing the description of B.

35

(3) The first formula in the definition “non-capital loss” in subsection 111(8) of the Act is replaced by the following:

**(A + B) - (D + D.1 + D.2)**

40

(4) The description of C in the definition “non-capital loss” in subsection 111(8) of the Act is repealed.

(5) Subsections (1) to (4) apply to the 1998 and subsequent taxation years.

13. (1) Section 111.1 of the Act is replaced by the following: 5

**Order of applying  
provisions**

**111.1** In computing an individual’s taxable income for a taxation year, the provisions of this Division shall be applied in the following order: sections 110, 111, 110.6 and 110.7. 10

(2) Subsection (1) applies to the 1998 and subsequent taxation years.

14. (1) The Act is amended by adding the following after section 115.1:

*Non-Resident Funds with Canadian Service Providers* 15

**Definitions**

**115.2** (1) The definitions in this subsection apply in this section. 20

“Canadian service  
provider”  
« *fournisseur de  
services canadien* » 25

“Canadian service provider” means 25

(a) a corporation resident in Canada; 30

(b) a trust resident in Canada; or 30

(c) a Canadian partnership.

“designated  
services” 35  
« *services  
déterminés* »

“designated services” provided to a fund in relation to qualified investments means any one or more of the services described in the following paragraphs: 40

(a) investment management and advice with respect to qualified investments, regardless of whether the manager has discretionary authority to buy or sell;

(b) purchasing qualified investments, exercising rights incidental to ownership of qualified investments such as voting, conversion, exchange, and sale, and entering into and executing agreements with respect to such purchasing and the exercising of such rights; and 5

(c) investment administration services with respect to qualified investments, such as having custody of investments, calculating and reporting investment values, executing investment transactions and transactions with investors in and beneficiaries of the fund, communicating with investors and beneficiaries, record keeping, accounting, auditing, legal services and marketing. 10 15

**“investment  
turnover rate”**

**« *taux de rotation  
des capitaux* »**

20

“investment turnover rate” of a fund for a year means the number determined by the formula

$$(dispositions - net redemptions)/average investments$$

25

where

*dispositions* is the total amount received or receivable by the fund in respect of dispositions by it during the year of property (other than investments redeemed at maturity and investments redeemed unilaterally by their issuers), 30

*net redemptions* is

35

(a) in the case of a non-resident investment fund, the amount by which the amount received or receivable by fund investors in respect of interests in the fund that are redeemed or repurchased by the fund during the year exceeds the total amount of contributions invested in the fund by fund investors during the year, and 40

(b) in the case of a non-resident pension fund, the amount by which the amount of benefits paid by the fund during the year exceeds the amount of contributions made to the fund during the year, 45



*average investments* is the average of all amounts each of which is the fair market value of all properties of the fund at a valuation time in the year, but in no case shall the interval between any two valuation times be less than 28 days or more than 31 days,

and where all amounts are expressed in the currency in which the accounts of the fund are ordinarily prepared.

**“non-resident  
investment fund”**

« *fonds de placement  
non-résident* »

“non-resident investment fund” means

(a) a non-resident corporation,

(b) a non-resident trust, or

(c) a partnership no member of which is resident in Canada,

the only undertaking of which is the investing of its funds in property.

**“non-resident  
pension fund”**

« *caisse de retraite  
non-résidente* »

“non-resident pension fund” means a non-resident corporation or non-resident trust the principal purpose of which is to administer or provide benefits under one or more superannuation, pension or retirement funds or plans or one or more funds or plans established to provide employee benefits, provided that

(a) such funds or plans principally relate to duties of employment performed outside Canada; and

(b) it is not reasonable to expect that any person will receive from the corporation or trust benefits the value of which exceeds 20% of the total value of property held by the corporation or trust.

**“promoter”**

« *promoteur* »

“promoter” of a fund means a person or partnership that initiates or directs the founding, organization or substantial reorganization of the fund, or a person or partnership affiliated with such a person or partnership.

**“qualified  
investment”**  
**« placement  
admissible »**

5

“qualified investment” means any property other than

(a) real property situated in Canada;

(b) Canadian resource property;

10

(c) timber resource property;

(d) a share of the capital stock of a corporation, or an interest in a partnership or trust, of which more than 50% of the fair market value is derived from one or more properties referred to in any of paragraphs (a) to (c); and 15

(e) an interest, option or right in respect of property included in any of paragraphs (a) to (d). 20

**“qualified non-  
resident fund”**  
**« fonds non-résident  
admissible »**

25

“qualified non-resident fund” means

(a) a non-resident pension fund; or

30

(b) a non-resident investment fund in which no particular person or partnership (other than a qualified non-resident fund) holds, directly or indirectly through one or more other holders of an interest in the fund, an interest the fair market value of which exceeds 20% of the total value of all interests in the fund and, for the purpose of this definition, a particular person or partnership is deemed to hold each interest in the fund held by a person or partnership affiliated with the particular person or partnership. 35

**Not carrying on  
business in Canada**

40

(2) For the purposes of subsection 115(1) and Part XIV, a qualified non-resident fund is not considered to be carrying on business in Canada in a taxation year solely by reason of engaging a Canadian service provider to provide in Canada in the year designated services in relation to qualified investments if 45



(a) the fund has not, at any time before the end of the year, directly or through its agents, directed any promotion of interests in the fund principally at, or sold such interests to, persons that the fund knew or ought to have known after reasonable enquiry were resident in Canada or partnerships that the fund knew or ought to have known after reasonable enquiry had members that were resident in Canada; 5

(b) the fund has not, at any time before the end of the year, filed any document with a public authority in Canada in accordance with the securities legislation of Canada or of any province in order to permit the distribution of interests in the fund to persons resident in Canada; and 10

(c) either

(i) the Canadian service provider deals with the fund and the fund's promoters at arm's length throughout the year, or 15

(ii) the fund's investment turnover rate for the year does not exceed three. 20

**(2) Subsection (1) applies to taxation years that end after 1998.**

**15. (1) Subsection 117(1) of the Act is replaced by the following:**

**Tax payable under  
this Part**

**117. (1)** For the purposes of this Division, except section 120 (other than subparagraph (a)(ii) of the definition "tax otherwise payable under this Part" in subsection 120(4)), tax payable under this Part, tax otherwise payable under this Part and tax under this Part shall be computed as if this Part were read without reference to Division E.1. 30

**(2) Subsection 117(6) of the Act is repealed.**

**(3) Subsections (1) and (2) apply to the 1998 and subsequent taxation years except that, in its application to the 1998 and 1999 taxation years, the reference to "subparagraph (a)(ii)" in subsection 117(1) of the Act, as enacted by subsection (1), shall be read as a reference to "paragraph (b)".** 35

**16. (1) The portion of subsection 117.1(1) of the Act before subparagraph (d)(ii) is replaced by the following:**

### Annual adjustment

**117.1** (1) Each of the amounts expressed in dollars in subsection 117(2), the description of B in subsection 118(1), subsections 118(2), 118.2(1), 118.3(1), 122.5(3) and 122.51(1) and (2) and Part I.2 in relation to tax payable under this Part or Part I.2 for a taxation year shall be adjusted so that the amount to be used under those provisions for the year is the total of 5

(a) the amount that would, but for subsection (3), be the amount to be used under those provisions for the preceding taxation year, and

(b) the product obtained by multiplying 10

(i) the amount referred to in paragraph (a)

by

**(2) Subsection 117.1(2) of the Act is repealed.**

**(3) Subsection (1) applies to the 2001 and subsequent taxation years.** 15

**(4) Subsection (2) applies to the 1999 and subsequent taxation years.**

**17. (1) Subparagraphs (a)(i) and (ii) of the description of B in subsection 118(1) of the Act are replaced by the following:**

(i) \$7,131, and 20

(ii) the amount determined by the formula

$$\underline{\$6,055} - (C - \underline{\$606})$$

where

C is the greater of \$606 and the income of the individual's spouse for the year or, where the individual and the individual's spouse are living separate and apart at the end of the year because of a breakdown of their marriage, the spouse's income for the year while married and not so separated, 25

**(2) Subparagraphs (b)(iii) and (iv) of the description of B in subsection 118(1) of the Act are replaced by the following:** 30

(iii) \$7,131, and

(iv) the amount determined by the formula

$$\underline{\$6,055} - (D - \underline{\$606})$$

where

D is the greater of \$606 and the dependent person's income for the year,

5

**(3) The portion of paragraph (b.1) of the description of B in subsection 118(1) of the Act before subparagraph (i) is replaced by the following:**

**Supplementary  
amount**

10

(b.1) for each individual (other than a trust), 1/2 of the amount, if any, by which the total of

**(4) Paragraph (b.1) of the description of B in subsection 118(1) of the Act is repealed.**

**(5) Paragraph (c) of the description of B in subsection 118(1) of the Act is replaced by the following:**

15

**Single status**

(c) except in the case of an individual entitled to a deduction because of paragraph (a) or (b), \$7,131,

**(6) The portion of paragraph (d) of the description of B in subsection 118(1) of the Act after subparagraph (ii) is replaced by the following:**

20

the amount determined by the formula

$$\underline{\$7,131} - E$$

where

25

E is the greater of \$4,778 and the dependant's income for the year, and

**(7) Subsections (1), (2), (5) and (6) apply to the 1999 and subsequent taxation years except that, in their application to the 1999 taxation year, the references to "\$7,131", "\$6,055", "\$606" and "\$4,778" in subparagraphs (a)(i) and (ii) and (b)(iii) and (iv) and paragraphs (c) and (d) of the description of B in subsection 118(1)**

30

of the Act, as enacted or amended by those subsections, as the case may be, shall be read as references to “\$6,794”, “\$5,718”, “\$572” and “\$4,441”, respectively.

(8) Subsection (3) applies to the 1999 taxation year.

(9) Subsection (4) applies to the 2000 and subsequent 5 taxation years.

18. (1) Paragraph (b) of the description of D in subsection 118.2(1) of the Act is replaced by the following:

(b) the amount used under paragraph (c) of the description of B in subsection 118(1) for the year. 10

(2) Subparagraph 118.2(2)(b.1)(ii) of the Act is replaced by the following:

(ii) no part of the remuneration is included in computing a deduction claimed in respect of the patient under section 63 or 64 or paragraph (b), (b.2), (c), (d) or (e) for any taxation year, 15

(3) Subsection 118.2(2) of the Act is amended by adding the following after paragraph (b.1):

(b.2) as remuneration for the patient’s care or supervision provided in a group home in Canada maintained and operated exclusively for the benefit of individuals who have a severe and prolonged 20 impairment if

(i) because of the patient’s impairment, the patient is a person in respect of whom an amount may be deducted under section 118.3 in computing a taxpayer’s tax payable under this Part for the 25 taxation year in which the expense is incurred,

(ii) no part of the remuneration is included in computing a deduction claimed in respect of the patient under section 63 or 64 or paragraph (b), (b.1), (c), (d) or (e) for any taxation year, and 30

(iii) each receipt filed with the Minister to prove payment of the remuneration was issued by the payee and contains, where the payee is an individual, that individual’s Social Insurance Number;

(4) Subsection 118.2(2) of the Act is amended by adding the 35 following after paragraph (l.8):

(l.9) as remuneration for therapy provided to the patient because of the patient’s severe and prolonged impairment, if



(i) because of the patient's impairment, an amount may be deducted under section 118.3 in computing a taxpayer's tax payable under this Part for the taxation year in which the remuneration is paid,

(ii) the therapy is prescribed by, and administered under the general supervision of,

(A) a medical doctor or a psychologist, in the case of mental impairment, and

(B) a medical doctor or an occupational therapist, in the case of a physical impairment,

(iii) at the time the remuneration is paid, the payee is neither the individual's spouse nor an individual who is under 18 years of age, and

(iv) each receipt filed with the Minister to prove payment of the remuneration was issued by the payee and contains, where the payee is an individual, that individual's Social Insurance Number;

(1.10) as remuneration for tutoring services that are rendered to, and are supplementary to the primary education of, the patient who

(i) has a learning disability or a mental impairment, and

(ii) has been certified in writing by a medical practitioner to be a person who, because of that disability or impairment, requires those services,

if the payment is made to a person ordinarily engaged in the business of providing such services to individuals who are not related to the payee.

**(5) Subsection (1) to (4) apply to the 1999 and subsequent taxation years except that, in its application to the 1999 taxation year, paragraph (b) of the description of D in subsection 118.2(1) of the Act, as enacted by subsection (1), shall be read as follows:**

**(b) \$7,044.**

**19. (1) Paragraph (a) of the description of C in section 118.8 of the Act is replaced by the following:**

**(a) the amount that would be the spouse's tax payable under this Part for the year if no amount were deductible under this Division (other than an amount deductible under subsection 118(1) because**

of paragraph (c) of the description of B in that subsection or under section 118.61 or 118.7)

(2) Subsection (1) applies to the 2000 and subsequent taxation years.

20. (1) The portion of subsection 120(3) of the Act before paragraph (a) is replaced by the following:

Definition of “the individual’s income for the year”

(3) For the purposes of this section, “the individual’s income for the year” means 10

(2) Subsection 120(3) of the Act is amended by striking out the word “and” at the end of paragraph (a), by adding the word “and” at the end of paragraph (b) and by adding the following after paragraph (b): 15

(c) in the case of an individual who is a specified individual in relation to the year, the individual’s income for the year computed without reference to paragraph 20(1)(ww).

(3) The definition “tax otherwise payable under this Part” in subsection 120(4) of the Act is replaced by the following: 20

“tax otherwise payable under this Part”

« impôt qu’il est par ailleurs tenu de payer en vertu de la présente partie » ou « impôt payable par ailleurs en vertu de la présente partie » 25 30

“tax otherwise payable under this Part” by an individual for a taxation year means the total of

(a) the greater of

(i) the individual’s minimum amount for the year determined under section 127.51, and 35

(ii) the amount that, but for this section, would be the individual's tax payable under this Part for the year if this Part were read without reference to

(A) subsection 120.4(2) and sections 126, 127, 127.4 and 127.41, and

5

(B) where the individual is a specified individual in relation to the year, section 121 in its application to dividends included in computing the individual's split income for the year, and

(b) where the individual is a specified individual in relation to the year, the amount, if any, by which

10

(i) 29% of the individual's split income for the year

exceeds

15

(ii) the total of all amounts each of which is an amount that may be deducted under section 121 and that can reasonably be considered to be in respect of a dividend included in computing the individual's split income for the year.

20

**(4) Subsections (1) to (3) apply to the 2000 and subsequent taxation years.**

**21. (1) Section 120.1 of the Act is repealed.**

**(2) Subsection (1) applies to the 1998 and subsequent taxation years.**

25

**22. (1) The portion of subsection 120.2(1) of the Act before paragraph (a) is replaced by the following:**

**Minimum tax carry-over**

**120.2 (1)** There may be deducted from the amount that, but for this section, section 120 and subsection 120.4(2), would be an individual's tax payable under this Part for a particular taxation year such amount as the individual claims not exceeding the lesser of

30

**(2) Subparagraph 120.2(1)(b)(i) of the Act is replaced by the following:**

35

(i) the amount that, but for this section, section 120 and subsection 120.4(2), would be the individual's tax payable under



this Part for the particular year if the individual were not entitled to any deduction under any of sections 126, 127 and 127.4

**(3) Paragraph 120.2(3)(b) of the Act is replaced by the following:**

(b) the amount that, but for section 120 and subsection 120.4(2), would be the individual's tax payable under this Part for the year if the individual were not entitled to any deduction under any of sections 126, 127 and 127.4, and

**(4) Subsections (1) to (3) apply to the 2000 and subsequent taxation years.**

**23. (1) The Act is amended by adding the following after section 120.3:**

*Lump-sum Payments*

**Definitions**

**120.31** (1) The definitions in subsection 110.2(1) apply in this section.

**Addition to tax payable**

(2) There shall be added in computing an individual's tax payable under this Part for a particular taxation year the total of all amounts each of which is the amount, if any, by which

(a) the individual's notional tax payable for an eligible taxation year to which a specified portion of a qualifying amount received by the individual relates and in respect of which an amount is deducted under section 110.2 in computing the individual's taxable income for the particular year

exceeds

(b) the individual's tax payable under this Part for the eligible taxation year.

**Notional tax payable**

(3) For the purpose of subsection (2), an individual's notional tax payable for an eligible taxation year, calculated for the purpose of computing the individual's tax payable under this Part for a taxation year (in this subsection referred to as "the year of receipt") in which the individual received a qualifying amount, is the total of

(a) the amount, if any, by which

(i) the amount that would be the individual's tax payable under this Part for the eligible taxation year if the total of all amounts, each of which is the specified portion, in relation to the eligible taxation year, of a qualifying amount received by the individual before the end of the year of receipt, were added in computing the individual's taxable income for the eligible taxation year 5

exceeds

10

(ii) the total of all amounts each of which is an amount, in respect of a qualifying amount received by the individual before the year of receipt, that was included because of this paragraph in computing the individual's notional tax payable under this Part for the eligible taxation year, and 15

(b) where the eligible taxation year ended before the taxation year preceding the year of receipt, an amount equal to the amount that would be calculated as interest payable on the amount determined under paragraph (a) if it were so calculated 20

(i) for the period that began on May 1 of the year following the eligible taxation year and that ended immediately before the year of receipt, and 25

(ii) at the prescribed rate that is applicable for the purpose of subsection 164(3) with respect to the period.

**(2) Subsection (1) applies to the 1995 and subsequent taxation years and, notwithstanding subsections 152(4) to (5) of the Act, any assessment of an individual's tax payable under the Act for any taxation year that ended before 1999 shall be made as is necessary to take into account the application of subsection (1).** 30

**24. (1) The Act is amended by adding the following after section 120.31:** 35

### *Tax on Split Income*

#### Definitions

**120.4 (1) The definitions in this subsection apply in this section.** 40

**“excluded amount”****« montant exclu »**

“excluded amount” in respect of an individual for a taxation year means an amount that is the income from a property acquired by or for the benefit of the individual as a consequence of the death of 5

(a) a parent of the individual; or

(b) any person, if the individual is 10

(i) enrolled as a full-time student during the year at a post-secondary educational institution (as defined in subsection 146.1(1)), or

(ii) an individual in respect of whom an amount may be deducted under section 118.3 in computing a taxpayer’s tax payable under this Part for the year. 15

**“specified****individual”**

20

**« particulier****déterminé »**

“specified individual” in relation to a taxation year means an individual who 25

(a) had not attained the age of 17 years before the year;

(b) at no time in the year was non-resident; and 30

(c) has a parent who is resident in Canada at any time in the year.

**“split income”****« revenu fractionné »**

35

“split income” of a specified individual for a taxation year means the total of all amounts (other than excluded amounts) each of which is

(a) an amount required to be included in computing the individual’s income for the year 40

(i) in respect of taxable dividends received by the individual in respect of shares of the capital stock of a corporation (other than shares of a class listed on a prescribed stock exchange or shares of the capital stock of a mutual fund corporation), or 45

(ii) because of the application of section 15 in respect of the ownership by any person of shares of the capital stock of a corporation (other than shares of a class listed on a prescribed stock exchange),

5

(b) a portion of an amount included because of the application of paragraph 96(1)(f) in computing the individual's income for the year, to the extent that the portion

(i) is not included in an amount described in paragraph (a), and 10

(ii) can reasonably be considered to be income derived from the provision of goods or services by a partnership or trust to or in support of a business carried on by

15

(A) a person who is related to the individual at any time in the year,

(B) a corporation of which a person who is related to the individual is a specified shareholder at any time in the year, 20  
or

(C) a professional corporation of which a person related to the individual is a shareholder at any time in the year, or

25

(c) a portion of an amount included because of the application of subsection 104(13) in respect of a trust (other than a mutual fund trust) in computing the individual's income for the year, to the extent that the portion

30

(i) is not included in an amount described in paragraph (a), and

(ii) can reasonably be considered

(A) to be in respect of taxable dividends received in respect of 35  
shares of the capital stock of a corporation (other than shares of a class listed on a prescribed stock exchange or shares of the capital stock of a mutual fund corporation),

(B) to arise because of the application of section 15 in respect 40  
of the ownership by any person of shares of the capital stock of a corporation (other than shares of a class listed on a prescribed stock exchange), or

(C) to be income derived from the provision of goods or 45  
services by a partnership or trust to or in support of a business carried on by

(I) a person who is related to the individual at any time in the year,

(II) a corporation of which a person who is related to the individual is a specified shareholder at any time in the year, or 5

(III) a professional corporation of which a person related to the individual is a shareholder at any time in the year.

10

### **Tax on split income**

(2) There shall be added to a specified individual's tax payable under this Part for a taxation year 29% of the individual's split income for the year. 15

### **Tax payable by a specified individual**

(3) Notwithstanding any other provision of this Act, where an individual is a specified individual in relation to a taxation year, the individual's tax payable under this Part for the year shall not be less than the amount by which 20

(a) the amount added under subsection (2) to the individual's tax payable under this Part for the year 25

exceeds

(b) the total of all amounts each of which is an amount that 30

(i) may be deducted under section 121 or 126 in computing the individual's tax payable under this Part for the year, and

(ii) can reasonably be considered to be in respect of an amount included in computing the individual's split income for the year. 35

**(2) Subsection (1) applies to the 2000 and subsequent taxation years.**

**25. (1) Subparagraph 122.3(1)(e)(i) of the Act is replaced by the following:** 40

(i) where section 114 does not apply to the individual in respect of the year, the individual's income for the year, and

**(2) The definition "tax otherwise payable under this Part for the year" in subsection 122.3(2) of the Act is replaced by the following:**



“tax otherwise

payable under this

Part for the year”

« *impôt qu’il est par*

*ailleurs tenu de payer*

*pour l’année en vertu*

*de la présente*

*partie »*

*ou « impôt payable*

*par ailleurs en vertu*

*de la présente partie*

*pour l’année »*

5

10

“tax otherwise payable under this Part for the year” means the amount that, but for this section, sections 120 and 120.2, subsection 120.4(2) and sections 121, 126, 127 and 127.4, would be the tax payable 15 under this Part for the year.

(3) Subsection (1) applies to the 1998 and subsequent taxation years.

(4) Subsection (2) applies to the 2000 and subsequent taxation years. 20

26. (1) The description of B in subsection 122.51(2) of the Act is replaced by the following:

B is 5% of the amount, if any, by which

(a) the total of all amounts each of which is the individual’s adjusted income for a taxation year that ends in the calendar year 25

exceeds

(b) \$17,419.

(2) Subsection (1) applies to the 1999 and subsequent taxation years except that, in its application to the 1999 taxation year, paragraph (b) of the description of B in subsection 122.51(2) of the 30 Act, as enacted by subsection (1), shall be read as follows:

(b) \$16,745.

27. (1) Section 125.1 of the Act is amended by adding the following after subsection (1):

## Generating electrical energy for sale

(2) A corporation that generates electrical energy for sale, or produces steam for use in the generation of electrical energy for sale, in a taxation year may deduct from its tax otherwise payable under this Part for the year 7% of the amount determined by the formula

$$A - B$$

where

A is the amount, if any, that would, if the definition “manufacturing or processing” in subsection (3), and in subsection 1104(9) of the *Income Tax Regulations*, were read without reference to paragraph (h) of those definitions (other than for the purpose of applying section 5201 of the Regulations) and if subsection (5) applied for the purpose of subsection (1), be the lesser of

(a) the amount determined under paragraph (1)(a) in respect of the corporation for the year, and

(b) the amount determined under paragraph (1)(b) in respect of the corporation for the year,

B is the amount, if any, that is the lesser of

(a) the amount determined under paragraph (1)(a) in respect of the corporation for the year, and

(b) the amount determined under paragraph (1)(b) in respect of the corporation for the year.

**(2) Section 125.1 of the Act is amended by adding the following after subsection (4):**

### Interpretation

(5) For the purpose of the description A in subsection 125.1(2) and for the purpose of applying the Regulations (other than section 5201 of the Regulations) to that subsection other than the description of B,

(a) electrical energy is deemed to be a good; and

(b) the generation of electrical energy for sale, or the production of steam for use in the generation of electrical energy for sale, is deemed to be, subject to paragraph (l) of the definition



“manufacturing or processing” in subsection (3), manufacturing or processing.

(3) Subsections (1) and (2) apply to taxation years that end after 1998 except that, in its application to such a taxation year that begins before 2002, the reference to “7%” in subsection 125.1(2) of the Act, as enacted by subsection (1), shall be read as a reference to the total of 5

(a) 0% multiplied by the number of days in the year that are before 1999,

(b) that proportion of ~~SM~~ 1%” that the number of days in the 1999 10  
calendar year is of the number of days in the taxation year,

(c) that proportion of “3%” that the number of days in the 2000  
calendar year is of the number of days in the taxation year,

(d) that proportion of “5%” that the number of days in the 2001  
calendar year is of the number of days in the taxation year, 15

(e) that proportion of “7%” that the number of days in the 2002  
calendar year is of the number of days in the taxation year, and

(f) that proportion of “7%” that the number of days in the 2003  
calendar year is of the number of days in the taxation year.

28. (1) Subclause 126(1)(b)(ii)(A)(I) of the Act is replaced by 20  
the following:

(I) where section 114 does not apply to the taxpayer in respect of the year, the taxpayer’s income for the year computed without reference to paragraph 20(1)(ww), and

(2) Subclause 126(2.1)(a)(ii)(A)(I) of the Act is replaced by 25  
the following:

(I) where section 114 does not apply to the taxpayer in respect of the year, the taxpayer’s income for the year computed without reference to paragraph 20(1)(ww), and

(3) Subparagraph 126(3)(b)(i) of the Act is replaced by 30  
the following:

(i) where section 114 does not apply to the individual in respect of the year, the individual’s income for the year computed without reference to paragraph 20(1)(ww), and

**(4) The description of A in the definition “tax for the year otherwise payable under this Part” in subsection 126(7) of the Act is replaced by the following:**

A is the amount that would be the tax payable under this Part for the year if that tax were determined without reference to section 120.3 and before making any deduction under any of sections 121, 122.3 and 125 to 127.41, and

**(5) Paragraphs (b) and (c) of the definition “tax for the year otherwise payable under this Part” in subsection 126(7) of the Act are replaced by the following:**

(b) in subparagraph (2)(c)(i) and paragraph (2.2)(b), the tax for the year payable under this Part (determined without reference to sections 120.3 and 123.3 and before making any deduction under any of sections 121, 122.3 and 124 to 127.41), and

(c) in subsection (2.1), the tax for the year payable under this Part (determined without reference to subsection 120(1) and sections 120.3 and 123.3 and before making any deduction under any of sections 121, 122.3 and 124 to 127.41);

**(6) Subsections (1) to (5) apply to the 1998 and subsequent taxation years except that, in their application to the 1998 and 1999 taxation years, subclauses 126(1)(b)(ii)(A)(I) and (2.1)(a)(ii)(A)(I) and subparagraph 126(3)(b)(i) of the Act, as enacted by subsections (1), (2) and (3), respectively, shall be read without reference to the expression “computed without reference to paragraph 20(1)(ww)”.**

**29. (1) The definitions “approved share” and “tax otherwise payable” in subsection 127.4(1) of the Act are replaced by the following:**

**“approved share”**

**« action approuvée »**

**“approved share” means a share of the capital stock of a prescribed labour-sponsored venture capital corporation, but does not include**

(a) a share issued by a registered labour-sponsored venture capital corporation the venture capital business of which was discontinued before the time of the issue, and

(b) a share issued by a prescribed labour-sponsored venture capital corporation (other than a registered labour-sponsored venture capital corporation) if, at the time of the issue, each province under the laws of which the corporation is a prescribed labour-sponsored venture

capital corporation has suspended or terminated its assistance in respect of the acquisition of shares of the capital stock of the corporation;

“tax otherwise payable”

5

« *impôt payable par ailleurs* »

“tax otherwise payable” by an individual means the amount that, but for this section, would be the individual’s tax payable under this Part.

**(2) Section 127.4 of the Act is amended by adding the following after subsection (1):**

**Amalgamations or mergers**

(1.1) Subsections 204.8(2) and 204.85(3) apply for the purpose of this section.

15

**(3) The definition “approved share” in subsection 127.4(1), as enacted by subsection (1), applies to the 1999 and subsequent taxation years.**

**(4) The definition “tax otherwise payable” in subsection 127.4(1), as enacted by subsection (1), applies to the 1998 and subsequent taxation years.**

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**(5) Subsection (2) applies after February 16, 1999.**

**30. (1) Section 127.5 of the Act is replaced by the following:**

**Obligation to pay minimum tax**

25

**127.5** Notwithstanding any other provision of this Act but subject to subsection 120.4(3) and section 127.55, where the amount that, but for section 120, would be determined under Division E to be an individual’s tax payable for a taxation year is less than the amount determined under paragraph (a) in respect of the individual for the year, the individual’s tax payable under this Part for the year is the total of

(a) the amount, if any, by which

(i) the individual’s minimum amount for the year determined under section 127.51

35

exceeds

(ii) the individual's special foreign tax credit determined under section 127.54 for the year, and

(b) the amount, if any, required by section 120 to be added to the individual's tax otherwise payable under this Part for the year. 5

**(2) Subsection (1) applies to the 1998 and subsequent taxation years except that, in its application to the 1998 and 1999 taxation years, section 127.5 of the Act, as enacted by subsection (1), shall be read without reference to the expression "subsection 120.4(3) and".**

**31. (1) Subsections 143(1) to (3) of the Act are replaced by the following:** 10

**Communal  
organizations**

**143. (1)** Where a congregation, or one or more business agencies of the congregation, carries on one or more businesses for purposes that 15 include supporting or sustaining the congregation's members or the members of any other congregation, the following rules apply:

(a) an *inter vivos* trust is deemed to be created on the day that is the later of

(i) December 31, 1976, and 20

(ii) the day the congregation came into existence;

(b) the trust is deemed to have been continuously in existence from the day determined under paragraph (a);

(c) the property of the congregation is deemed to be the property of the trust; 25

(d) the property of each business agency of the congregation in a calendar year is deemed to be property of the trust throughout the portion of the year throughout which the trust exists;

(e) where the congregation is a corporation, the corporation is deemed to be the trustee having control of the trust property; 30

(f) where the congregation is not a corporation, its council, committee of leaders, executive committee, administrative committee, officers or other group charged with the management of the



congregation are deemed to be the trustees having control of the trust property;

(g) the congregation is deemed to act and have always acted as agent for the trust in all matters relating to its businesses and other activities;

5

(h) each business agency of the congregation in a calendar year is deemed to have acted as agent for the trust in all matters in the year relating to its businesses and other activities;

(i) the members of the congregation are deemed to be the beneficiaries under the trust;

10

(j) tax under this Part is payable by the trust on its taxable income for each taxation year;

(k) in computing the income of the trust for any taxation year,

(i) subject to paragraph (l), no deduction may be made in respect of salaries, wages or benefits of any kind, provided to the 15 members of the congregation, and

(ii) no deduction may be made under subsection 104(6), except to the extent that any portion of the trust's income (determined without reference to that subsection) is allocated to the members of the congregation in accordance with subsection (2);

20

(l) for the purpose of applying section 20.01 to the trust

(i) each member of the congregation is deemed to be a member of the trust's household, and

25

(ii) section 20.01 shall be read without reference to paragraphs 20.01(2)(b) and (c) and subsection 20.01(3); and

(m) where the congregation or one of the business agencies is a corporation, section 15.1 shall, except for the purposes of 30 paragraphs 15.1(2)(a) and (c) (other than subparagraphs 15.1(2)(c)(i) and (ii)), apply as if this subsection were read without reference to paragraphs (c), (d), (g) and (h).

#### **Election in respect of income**

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(2) Where the *inter vivos* trust referred to in subsection (1) in respect of a congregation so elects in respect of a taxation year in writing filed with the Minister on or before the trust's filing-due date for the year and



all the congregation’s participating members are specified in the election in accordance with subsection (5), the following rules apply:

(a) for the purposes of subsections 104(6) and (13), the amount payable in the year to a particular participating member of the congregation out of the income of the trust (determined without reference to subsection 104(6)) is the amount determined by the formula: 5

$$0.8 (A \times B/C) + D + ((0.2A - E)/F)$$

10

where

A is the taxable income of the trust for the year (determined without reference to subsection 104(6) and specified future tax consequences for the year), 15

B is

(i) where the particular member is identified in the election as a person to whom this subparagraph applies (in this subsection 20 referred to as a “designated member”), 1, and

(ii) in any other case, 0.5,

C is the total of 25

(i) the number of designated members of the congregation, and

(ii) ½ of the number of other participating members of the congregation in respect of the year, 30

D is the amount, if any, that is specified in the election as an additional allocation under this subsection to the particular member, 35

E is the total of all amounts each of which is an amount specified in the election as an additional allocation under this subsection to a participating member of the congregation in respect of the year, and 40

F is the number of participating members of the congregation in respect of the year;

(b) the designated member of each family at the end of the year is deemed to have supported the other members of the family during the year and the other members of the family are deemed to have 45

been wholly dependent on the designated member for support during the year; and

(c) the taxable income for the year of each member of the congregation shall be computed without reference to subsection 110(2). 5

#### **Refusal to accept election**

(3) An election under subsection (2) in respect of a congregation for a particular taxation year is not binding on the Minister unless all taxes, interest and penalties payable under this Part, as a consequence of the application of subsection (2) to the congregation for preceding taxation years, are paid at or before the end of the particular year. 10

#### **(2) Subsection 143(3.1) of the Act is replaced by the following:**

#### **Election in respect of gifts**

15

(3.1) For the purposes of section 118.1, where the fair market value of a gift made in a taxation year by an *inter vivos* trust referred to in subsection (1) in respect of a congregation would, but for this subsection, be included in the total charitable gifts, total Crown gifts, total cultural gifts or total ecological gifts of the trust for the year and the trust so elects in its return of income under this Part for the year, 20

(a) the trust is deemed not to have made the gift; and

(b) each participating member of the congregation is deemed to have made, in the year, such a gift the fair market value of which is the amount determined by the formula 25

$$A \times B/C$$

where

A is the fair market value of the gift made by the trust,

B is the amount determined for the year in respect of the member under paragraph (2)(a) as a consequence of an election under subsection (2) by the trust, and 30

C is the total of all amounts each of which is an amount determined for the year in respect of a participating member of the congregation under paragraph (2)(a) as a consequence of an election under subsection (2) by the trust. 35

**(3) The definition “congregation” in subsection 143(4) of the Act is replaced by the following:**

**“congregation”**

**« congrégation »**

“congregation” means a community, society or body of individuals, 5  
whether or not incorporated,

(a) the members of which live and work together,

(b) that adheres to the practices and beliefs of, and operates 10  
according to the principles of, the religious organization of which it is a constituent part,

(c) that does not permit any of its members to own any property in 15  
their own right, and

(d) that requires its members to devote their working lives to the 20  
activities of the congregation;

**(4) Subsection 143(4) of the Act is amended by adding the 25  
following definitions in alphabetical order:**

**“business agency”**

**« agence**

**commerciale »**

“business agency” of a congregation at any time in a calendar year 25  
means a corporation, trust or other person, where the congregation owned all the shares of the capital stock of the corporation (except directors’ qualifying shares) or every interest in the trust or other person, as the case may be, throughout the portion of the calendar year throughout which both the congregation and the corporation, 30  
trust, or other person, as the case may be, were in existence;

**“participating member”**

**« membre**

**participant »**

“participating member” of a congregation in respect of a taxation year 35  
means an individual who, at the end of the year, is an adult who is a member of the congregation;

“total ecological  
gifts”

« *total des dons de  
biens écosensibles* »

5

“total ecological gifts” has the meaning assigned by subsection 118.1(1).

**(5) Subsection 143(5) of the Act is replaced by the following:**

**Specification of  
family members**

(5) For the purpose of applying subsection (2) to a particular election 10  
by the *inter vivos* trust referred to in subsection (1) in respect of a  
congregation for a particular taxation year,

(a) subject to paragraph (b), a participating member of the  
congregation is considered to have been specified in the particular 15  
election in accordance with this subsection only if the member is  
identified in the particular election and,

(i) where the member’s family includes only one adult at the end  
of the particular year, the member is identified in the particular 20  
election as a person to whom subparagraph (i) of the description  
of B in subsection (2) (in this subsection referred to as the  
“relevant subparagraph”) applies, and

(ii) in any other case, only one of the adults in the member’s 25  
family is identified in the particular election as a person to whom  
the relevant subparagraph applies; and

(b) an individual is considered not to have been specified in the  
particular election in accordance with this subsection if 30

(i) the individual is one of two individuals who were married to  
each other at the end of a preceding taxation year of the trust and  
at the end of the particular year,

35

(ii) one of those individuals was

(A) where the preceding year ended before 1998, specified in  
an election under subsection (2) by the trust for the preceding  
year, and 40

(B) in any other case, identified in an election under  
subsection (2) by the trust for the preceding year as a person  
to whom the relevant subparagraph applied, and



(iii) the other individual is identified in the particular election as a person to whom the relevant subparagraph applies.

**(6) Subsection (1), paragraphs 143(3.1)(a) and (b) of the Act, as enacted by subsection (2), subsection (3), the definitions “business agency” and “participating member” in subsection 143(4) of the Act, as enacted by subsection (4), and subsection (5) apply to the 1998 and subsequent taxation years except that, for taxation years that end before 2001, the definition “business agency” in subsection 143(4) of the Act, as enacted by subsection (4), shall be read as follows:**

“business agency” of a congregation at any time in a particular calendar year means

(a) a corporation, trust or other person, where the congregation owned all the shares of the capital stock of the corporation (except directors’ qualifying shares) or every interest in the trust or other person, as the case may be, throughout the portion of the particular year throughout which both the congregation and the corporation, trust or other person, as the case may be, existed, or

(b) a corporation, trust or other person of which the congregation

(i) has effective management or control throughout the portion of the particular year throughout which both the congregation and the corporation, trust or other person, as the case may be, were in existence, and

(ii) had effective management or control during a taxation year of the corporation, trust or other person that began before March 1999 and ended in the particular year;

**(7) The portion of subsection 143(3.1) of the Act before paragraph (a), as enacted by subsection (2), applies to the 1995 and subsequent taxation years.**

**(8) The definition “total ecological gifts” in subsection 143(4) of the Act, as enacted by subsection (4), applies to gifts made after February 27, 1995.**

**32. (1) Paragraph (b) of the definition “refund of premiums” in subsection 146(1) of the Act is replaced by the following:**

(b) any amount paid out of or under a registered retirement savings plan of the annuitant (other than any part of the amount that is a tax-paid amount in respect of the plan) after the death to a child or grandchild (in this definition referred to as a “dependant”) of the



annuitant, who was, at the time of the death, financially dependent on the annuitant for support,

**(2) The portion of the definition “refund of premiums” in subsection 146(1) of the Act after paragraph (b) is replaced by the following:**

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and for the purpose of paragraph (b), it is assumed, unless the contrary is established, that a dependant was not financially dependent on the annuitant for support at the time of the annuitant’s death if the dependant’s income for the year preceding the taxation year in which the annuitant died exceeded the amount used under paragraph (c) of the description of B in subsection 118(1) for that preceding year;

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**(3) Subsection 146(8.1) of the Act is replaced by the following:**

**Deemed receipt of  
refund of premiums**

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(8.1) Where a portion of an amount paid out of or under a registered retirement savings plan of a deceased annuitant to the annuitant’s legal representative would have been a refund of premiums if it had been paid under the plan to a beneficiary of the deceased’s estate, it shall, to the extent it is so designated jointly by the legal representative and the beneficiary in prescribed form filed with the Minister, be deemed to be received by the beneficiary (and not by the legal representative) at the time it was so paid as a benefit that is a refund of premiums.

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**(4) Subsection (1) applies to deaths that occur after 1995 except that, in respect of the death of an individual that occurred after 1995 and before 1999, paragraph (b) of the definition “refund of premiums” in subsection 146(1) of the Act shall be read without reference to subsection (1) in connection with an amount paid at a particular time out of a registered retirement savings plan or registered retirement income fund, unless the following persons jointly elect otherwise in writing filed with the Minister of National Revenue before May 2000 (or before such later day as is acceptable to the Minister):**

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**(a) the legal representative of the deceased individual; and**

**(b) the individual in whose income an amount would be required to be included as a result of the election, or would be so required to be included if Part I of the Act applied.**

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**(5) Notwithstanding subsections 152(4) to (5) of the Act, the Minister of National Revenue shall make such assessments,**

reassessments and additional assessments of tax, interest and penalties and such determinations and redeterminations as are necessary to give effect to an election under subsection (4).

(6) Subsection (2) applies to the 2000 and subsequent taxation years except that, in its application to the 2000 taxation year, the reference to “the amount used under paragraph (c) of the description of B in subsection 118(1) for that preceding taxation year” in the portion of the definition “refund of premiums” in subsection 146(1) of the Act after paragraph (b), as enacted by subsection (2), shall be read as a reference to “\$7,044”.

(7) Subsection (3) applies to the 1999 and subsequent taxation years.

33. (1) Section 160 of the Act is amended by adding the following after subsection (1.1):

**Joint liability — tax  
on split income**

(1.2) A parent of a specified individual is jointly and severally liable with the individual for the amount required to be added because of subsection 120.4(2) in computing the specified individual’s tax payable under this Part for a taxation year if, during the year, the parent

(a) carried on a business that purchased goods or services from a business the income of which is directly or indirectly included in computing the individual’s split income for the year;

(b) was a specified shareholder of a corporation that purchased goods or services from a business the income of which is directly or indirectly included in computing the individual’s split income for the year;

(c) was a specified shareholder of a corporation, dividends on the shares of the capital stock of which were directly or indirectly included in computing the individual’s split income for the year;

(d) was a shareholder of a professional corporation that purchased goods or services from a business the income of which is directly or indirectly included in computing the individual’s split income for the year; or

(e) was a shareholder of a professional corporation, dividends on the shares of the capital stock of which were directly or indirectly included in computing the individual’s split income for the year.

(2) Subsection (1) applies to the 2000 and subsequent taxation years.

**34. Subsection 161(12) of the Act is repealed.**

**35. (1) The Act is amended by adding the following after section 161:**

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*Offset of Refund Interest and Arrears Interest*

**Definitions**

**161.1 (1)** The definitions in this subsection apply in this section. 10

**“accumulated  
overpayment  
amount”**

« *trop-payé*  
*accumulé* » 15

“accumulated overpayment amount” of a corporation for a period means the overpayment amount of the corporation for the period together with refund interest (including, for greater certainty, compound interest) that accrued with respect to the overpayment amount before the date specified under paragraph (3)(b) by the corporation in its application for the period. 20

**“accumulated  
underpayment  
amount”** 25

« *moins-payé*  
*accumulé* » 30

“accumulated underpayment amount” of a corporation for a period means the underpayment amount of the corporation for the period together with arrears interest (including, for greater certainty, compound interest) that accrued with respect to the underpayment amount before the date specified under paragraph (3)(b) by the corporation in its application for the period. 35

**“arrears interest”**

« *intérêts débiteur* » 40

“arrears interest” means interest computed under paragraph 129(2.2)(b), 131(3.2)(b), 132(2.2)(b), 133(7.02)(b) or 160.1(1)(b), subsection 161(1) or (11), paragraph 161.1(5)(b), 164(3.1)(b) or (4)(b) or subsection 187(2).

**“overpayment  
amount”**

« *trop-payé* »

“overpayment amount” of a corporation for a period means the amount 5  
referred to in subparagraph (2)(a)(i) that is refunded to the  
corporation, or in subparagraph (2)(a)(ii) to which the corporation  
is entitled.

**“refund interest”**

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« *intérêts créditeurs* »

“refund interest” means interest computed under subsection 129(2.1),  
131(3.1), 132(2.1), 133(7.01), or 164(3) or (3.2).

15

**“underpayment  
amount”**

« *moins-payé* »

“underpayment amount” of a corporation for a period means the amount 20  
referred to in paragraph (2)(b) payable by the corporation on which  
arrears interest is computed.

**Concurrent refund  
interest and  
arrears interest**

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(2) A corporation may apply in writing to the Minister for the  
reallocation of an accumulated overpayment amount on account of an  
accumulated underpayment amount if, in respect of tax paid or payable 30  
by the corporation under this Part or Part I.3, II, IV, IV.1, VI, VI.1  
or XIV,

(a) refund interest for any period of time that begins after 1999

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(i) is computed on an amount refunded to the corporation, or

(ii) would be computed on an amount to which the corporation is  
entitled, if that amount were refunded to the corporation; and

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(b) arrears interest for the same period of time is computed on an  
amount payable by the corporation.

**Contents of  
application**

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(3) A corporation’s application referred to in subsection (2) for a  
period is deemed not to have been made unless



- (a) it specifies the amount to be reallocated, which shall not exceed the lesser of the corporation's accumulated overpayment amount for the period and its accumulated underpayment amount for the period;
- (b) it specifies the effective date for the reallocation, which shall not be earlier than the latest of
- (i) the date from which refund interest is computed on the corporation's overpayment amount for the period, or would be so computed if the overpayment amount were refunded to the corporation,
  - (ii) the date from which arrears interest is computed on the corporation's underpayment amount for the period, and
  - (iii) January 1, 2000; and
- (c) it is made on or before the day that is 90 days after the latest of
- (i) the day of mailing of a notice of assessment for the corporation's taxation year to which its overpayment amount or underpayment amount for the period relates,
  - (ii) if the corporation has served a notice of objection to an assessment referred to in subparagraph (i), the day of mailing of the notification under subsection 165(3) by the Minister in respect of the notice of objection,
  - (iii) if the corporation has appealed, or sought leave to appeal, from an assessment referred to in subparagraph (i) to a court of competent jurisdiction, the day on which the court denies leave to appeal, the appeal is discontinued, or final judgment is pronounced in the appeal, and
  - (iv) the day of mailing of a notice to the corporation indicating that the Minister has determined the corporation's overpayment amount for the period.

### Reallocation

(4) The amount to be reallocated that is specified under paragraph (3)(a) by a corporation is deemed to have been refunded to the corporation and paid on account of the accumulated underpayment amount on the date specified under paragraph (3)(b) by the corporation.



## **Repayment of refund**

(5) If, before an application in respect of a period is made under subsection (2) by a corporation, a portion of the amount to be reallocated has been refunded to the corporation, the following rules apply: 5

(a) a particular amount equal to the total of 10

(i) the portion of the amount to be reallocated that was previously refunded to the corporation, and

(ii) refund interest paid or credited to the corporation in respect of that portion 15

is deemed to have become payable by the corporation on the day on which the portion was refunded; and

(b) the corporation shall pay to the Receiver General interest at the prescribed rate on the particular amount from the day referred to in paragraph (a) to the date of payment. 20

## **Consequential reallocations**

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(6) If a particular reallocation of an accumulated overpayment amount under subsection (4) results in a new accumulated overpayment amount of the corporation for a period, the new accumulated overpayment amount shall not be reallocated under this section unless the corporation so applies in its application for the particular reallocation. 30

## **Assessments**

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(7) Notwithstanding subsections 152(4), (4.01) and (5), the Minister shall assess or reassess interest and penalties payable by a corporation in respect of any taxation year as necessary in order to take into account a reallocation of amounts under this section.

(2) Subsection (1) applies after 1999. 40

36. (1) Subsection 163(2.9) of the Act is replaced by the following:

## Where partnership liable to penalty

(2.9) Where a partnership is liable to a penalty under subsection (2.4) or section 163.2 or 237.1, sections 152, 158 to 160.1, 161, and 164 to 167 and Division J apply, with any changes that the circumstances require, in respect of the penalty as if the partnership were a corporation. 5

### (2) Subsection 163(3) of the Act is replaced by the following:

#### Burden of proof in respect of penalties

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(3) Where, in an appeal under this Act, a penalty assessed by the Minister under this section or section 163.2 is in issue, the burden of establishing the facts justifying the assessment of the penalty is on the Minister.

### 37. The Act is amended by adding the following after section 163.1: 15

#### *Misrepresentation of a Tax Matter by a Third Party*

#### Definitions

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**163.2** (1) The definitions in this subsection apply in this section.

#### “culpable conduct”

« *conduite  
coupable* »

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“culpable conduct” means conduct, whether an act or a failure to act, that

(a) is tantamount to intentional conduct; 30

(b) shows an indifference as to whether this Act is complied with; or

(c) shows a wilful, a reckless or a wanton disregard of the law. 35

#### “entity”

« *entité* »

“entity” includes an association, a corporation, a fund, a joint venture, an organization, a partnership, a syndicate and a trust. 40

**“false statement”****« faux énoncé »**

“false statement” includes a statement that is misleading because of an omission from the statement.

5

**“gross entitlements”****« droits à paiement »**

“gross entitlements” of a person at any time, in respect of a planning activity or a valuation activity of the person, means all amounts to which the person, or another person not dealing at arm’s length with the person, is entitled, either before or after that time and either absolutely or contingently, to receive or obtain in respect of the activity.

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**“participates”****« participer »**

“participates” includes

20

(a) causing a subordinate to act or to omit information; and

(b) knowing of, and not making a reasonable attempt to prevent, the participation by a subordinate in an act or an omission of information.

25

**“person”****« personne »**

“person” includes a partnership.

30

**“planning activity”****« activité de  
planification »**

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“planning activity” includes

(a) organizing or creating, or assisting in the organization or creation of, an entity, a plan, a scheme or an arrangement; and

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(b) participating, directly or indirectly, in the selling of an interest in, or the promotion of, an entity, a plan, a scheme or an arrangement.

**“subordinate”****« subalterne »**

“subordinate”, in respect of a particular person, includes any other person over whose activities the particular person has direction, supervision or control whether or not the other person is an employee of the particular person or of another person, except that, if the particular person is a member of a partnership, the other person is not a subordinate of the particular person solely because the particular person is a member of the partnership.

**“valuation activity”****« activité****d'évaluation »**

“valuation activity” of a person means anything done by the person in determining the value of a property or a service.

**Penalty for  
misrepresentations  
in tax planning  
arrangements**

(2) Every person who makes or furnishes, or causes another person to make or furnish, a statement that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct, is a false statement that could be used by another person (in subsection (6) referred to as the “other person”) for a purpose of this Act is liable to a penalty in respect of the false statement.

**Amount of penalty**

(3) The penalty to which a person is liable under subsection (2) in respect of a false statement is

(a) where the statement is made in the course of a planning activity or a valuation activity, the greater of \$1,000 and the total of the person's gross entitlements, at the time at which the notice of assessment of the penalty is sent to the person, in respect of the planning activity and the valuation activity; and

(b) in any other case, \$1,000.

**Penalty for  
participating in a  
misrepresentation**

(4) Every person who makes, or participates in, assents to or acquiesces in the making of, a statement to, or by or on behalf of, another person (in this subsection and subsections (5) and (6) referred to as the “other person”) that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct, is a false statement that could be used by or on behalf of the other person for a purpose of this Act is liable to a penalty in respect of the false statement.

**Amount of penalty**

(5) The penalty to which a person is liable under subsection (4) in respect of a false statement is the greater of

- (a) \$1,000, and
- (b) the penalty to which the other person would be liable under subsection 163(2) if the other person made the statement in a return filed for the purposes of this Act and knew the statement was false.

**Reliance in  
good faith**

(6) For the purpose of applying subsection (2), other than in respect of a statement that is made in the course of a planning activity or a valuation activity, and for the purpose of applying subsection (4), a person is not considered to have acted in circumstances amounting to culpable conduct solely because the person relied, in good faith, on information provided to the person by the other person or, because of such reliance, failed to verify, investigate or correct the information.

**False statements  
in respect of a  
particular  
arrangement**

(7) For the purpose of applying this section (other than subsections (4) and (5)),

- (a) where a person makes or furnishes, or causes another person to make or furnish, two or more false statements, the false statements are deemed to be one false statement if the statements are made or furnished in the course of



(i) one or more planning activities that are in respect of a particular entity, plan, scheme or arrangement, or

(ii) a valuation activity that is in respect of a particular property or service;

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(b) for greater certainty, a particular entity, plan, scheme or arrangement includes an entity, a plan, a scheme or an arrangement in respect of which

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(i) an interest is required to have, or has, an identification number issued under section 237.1 that is the same number as the number that applies to each other interest in the entity, the plan, the scheme or the arrangement, or

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(ii) an amount is renounced in circumstances to which subsection 66(12.7) applies; and

(c) a person is not considered to have participated in a planning activity or a valuation activity solely because the person provided clerical or secretarial services with respect to the activity.

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## Valuations

(8) Notwithstanding subsection 163(3), a statement as to the value of a property or a service (which value is in this subsection referred to as the “stated value”), made by the person who opined on the stated value, or by a person engaged in an activity described in paragraph (b) of the definition “planning activity” in subsection (1), is deemed to be a statement that the person would reasonably be expected to know, but for circumstances amounting to culpable conduct, is a false statement if the stated value is

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(a) less than the product obtained when the prescribed percentage for the property or service is multiplied by the fair market value of the property or service; or

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(b) greater than the product obtained when the prescribed percentage for the property or service is multiplied by the fair market value of the property or service.

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## Exception

(9) Subsection (8) does not apply to a person in respect of a statement as to a value if the person establishes that that stated value was reasonable in the circumstances and the statement was provided in good faith.

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### Special rules

(10) For the purpose of applying this section,

(a) where a person is assessed a penalty under subsection (2) the amount of which is based on the person's gross entitlements at any time in respect of a planning activity or a valuation activity and another assessment of the penalty is made at a later time,

(i) if the person's gross entitlements in respect of the activity are greater at that later time, the assessment of the penalty made at that later time is deemed to be an assessment of a separate penalty, and

(ii) in any other case, the notice of assessment of the penalty sent before that later time is deemed not to have been sent; and

(b) a person's gross entitlements at any time in respect of a planning activity, or a valuation activity, in the course of which the person makes or furnishes, or causes another person to make or furnish, a false statement shall exclude the total of all amounts each of which is the amount of a penalty (other than a penalty the assessment of which is void because of subsection (11)) determined under paragraph (3)(a) in respect of the false statement for which notice of the assessment was sent to the person before that time.

### Assessment void

(11) For the purposes of this Act, if an assessment of a penalty under subsection (2) or (4) is vacated, the assessment is deemed to be void.

### Maximum penalty

(12) A person who is liable at any time to a penalty under both subsections (2) and (4) in respect of the same false statement is liable to pay a penalty that is not more than the greater of

(a) the total amount of the penalties to which the person is liable at that time under subsection (2) in respect of the statement, and

(b) the total amount of the penalties to which the person is liable at that time under subsection (4) in respect of the statement.

**38. (1) Paragraph 165(1.1)(a) of the Act is replaced by the following:**

(a) under subsection 67.5(2) or 152(1.8), subparagraph 152(4)(b)(i) or subsection 152(4.3) or (6), 161.1(7), 164(4.1), 220(3.4) or 245(8)

or in accordance with an order of a court vacating, varying or restoring an assessment or referring the assessment back to the Minister for reconsideration and reassessment,

**(2) Subsection (1) applies after 1999.**

**39. (1) The portion of paragraph 180.1(1)(a) of the Act before subparagraph (i) is replaced by the following:** 5

(a) 1/2 of the amount, if any, by which

**(2) Subsection 180.1(1) of the Act is replaced by the following:**

#### **Individual surtax**

**180.1 (1)** Every individual shall pay a tax under this Part for each 10  
taxation year equal to 5% of the amount, if any, by which the tax  
payable under Part I by the individual for the year exceeds \$12,500.

**(3) Subsection (1) applies to the 1999 taxation year.**

**(4) Subsection (2) applies to the 2000 and subsequent 15  
taxation years.**

**40. (1) The description of C in subsection 190.1(1.2) of the Act is replaced by the following:**

C is the number of days in the year that are after February 27, 1995  
and before November 2000.

**(2) Subsection (1) applies to taxation years that end after 20  
February 27, 1995.**

**41. (1) Section 204.8 of the Act is renumbered as  
subsection 204.8(1).**

**(2) The definition “eligible business entity” in subsection 204.8(1)  
of the Act is replaced by the following:** 25

“eligible business  
entity”

« *entreprise  
admissible* »

“eligible business entity”, at any time, means a particular entity that is 30

(a) a prescribed corporation, or

(b) a Canadian partnership or a taxable Canadian corporation, all or substantially all of the fair market value of the property of which is, at that time, attributable to

(i) property used in a specified active business carried on by the particular entity or by a corporation controlled by the particular entity, 5

(ii) shares of the capital stock or debt obligations of one or more entities that, at that time, are eligible business entities related to the particular entity, or

(iii) any combination of properties described in subparagraph (i) or (ii); 10

**(3) Subsection 204.8(1) of the Act is amended by adding the following definition in alphabetical order:**

**“start-up period”**

« *période de  
démarrage* »

15

“start-up period” of a corporation means

(a) subject to paragraph (c), in the case of a corporation that first issued Class A shares before February 17, 1999, the corporation’s 20  
taxation year in which it first issued those shares and the four  
following taxation years,

(b) subject to paragraph (c), in the case of a corporation that first issues Class A shares after February 16, 1999, the corporation’s 25  
taxation year in which it first issues those shares and the following  
taxation year, or

(c) where a corporation files an election with its return under this Part for a particular taxation year of the corporation that ends after 30  
1998 and that is referred to in paragraph (a) or (b), the period, if  
any, consisting of the taxation years referred to in paragraph (a) or  
(b), as the case may be, other than the particular year and all taxation  
years following the particular year.

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**(4) Section 204.8 of the Act, as amended by subsection (1), is amended by adding the following after subsection (1):**



**When venture  
capital business  
discontinued**

(2) For the purposes of section 127.4, this Part and Part XII.5, a corporation discontinues its venture capital business

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(a) at the time its articles cease to comply with paragraph 204.81(1)(c) and would so cease to comply if it had been incorporated after December 5, 1996;

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(b) at the time it begins to wind-up;

(c) immediately before the time it amalgamates or merges with one or more other corporations to form one corporate entity (other than an entity deemed by paragraph 204.85(3)(d) to have been registered under this Part);

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(d) at the time it becomes a revoked corporation, if one of the grounds on which the Minister could revoke its registration for the purposes of this Part is set out in paragraph 204.81(6)(a.1); or

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(e) at the first time after the revocation of its registration for the purposes of this Part that it fails to comply with any of the provisions of its articles governing its authorized capital, the management of its business and affairs, the reduction of paid-up capital or the redemption or transfer of its Class A shares.

**Date of issue of  
Class A shares**

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(3) For the purposes of this Part and subsection 211.8(1), in determining the time of the issue or the original acquisition of Class A shares, identical Class A shares held by a person are deemed to be disposed of by the person in the order in which the shares were issued.

(5) Subsections (1) and (2) apply to the 1999 and subsequent taxation years.

(6) Subsection (3) applies after 1997.

(7) Subsection (4) applies after February 16, 1999.

42. (1) Paragraph 204.81(6)(g) of the Act is repealed.

(2) Section 204.81 of the Act is amended by adding the following after subsection (8):

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## Voluntary de-registration

(8.1) Where at any time the Minister receives a certified copy of a resolution of the directors of a corporation seeking the revocation of the corporation's registration under this Part,

(a) the registration is revoked at that time; and

(b) the Minister shall, with all due dispatch, give notice in the *Canada Gazette* of the revocation.

## Application of subsection 248(7)

(8.2) Subsection 248(7) does not apply for the purpose of subsection (8.1).

(3) Subsection (1) applies after February 16, 1999.

(4) Subsection (2) applies to resolutions received by the Minister of National Revenue after the day on which this Act is assented to.

**43. (1) The portion of subsection 204.82(1) of the Act before paragraph (a) is replaced by the following:**

## Recovery of credit

**204.82 (1)** Where, at any time that is both in a taxation year included in the start-up period of a corporation that was registered under this Part and before its venture capital business is first discontinued,

(2) Subsection 204.82(2) of the Act is replaced by the following:

## Liability for tax

(2) Each corporation that has been registered under this Part shall, in respect of each month that ends before its venture capital business is first discontinued and in a particular taxation year of the corporation that begins after the end of the corporation's start-up period (or, where the corporation has no start-up period, that begins after the time the corporation first issues a Class A share), pay a tax under this Part equal to the amount obtained when the greatest investment shortfall at any time that is in the month and in the particular year (in this section and sections 204.81 and 204.83 referred to as the "monthly deficiency") is multiplied by 1/60 of the prescribed rate of interest in effect during the month.

**(3) Subparagraph 204.82(2.2)(d)(i) of the Act is replaced by the following:**

(i) 150% of the cost to the corporation of the eligible investment at that time where the eligible investment is

(A) a property acquired by the corporation after February 18, 1997 (other than a property to which subparagraph (i.1) applies) that would be an eligible investment of the corporation if the reference to \$50,000,000 in paragraph (f) of the definition “eligible investment” in subsection 204.8(1) were read as “\$10,000,000”, or

(B) a share of the capital stock of a prescribed corporation,

(i.1) 200% of the cost to the corporation of the eligible investment at that time where the eligible investment is a property acquired by the corporation after February 16, 1999 (other than a property described in clause (i)(B)) that would be an eligible investment of the corporation if the reference to “\$50,000,000” in paragraph (f) of the definition “eligible investment” in subsection 204.8(1) were read as “\$2,500,000”, and

**(4) Section 204.82 of the Act is amended by adding the following after subsection (5):**

**Further matching of  
amounts payable to  
a province**

(6) Where

(a) a particular amount is payable (other than interest on an amount to which this subsection applies) by a registered labour-sponsored venture capital corporation or a revoked corporation to the government of a province as a consequence of a failure of a prescribed corporation to acquire sufficient properties of a character described in a law of the province, and

(b) the particular amount became payable before the corporation first discontinued its venture capital business,

the corporation shall pay a tax under this Part for the taxation year in which the particular amount became payable equal to that amount.

**(5) Subsections (1) to (4) apply to the 1999 and subsequent taxation years.**

**44. (1) Subsection 204.83(2) of the Act is replaced by the following:**

**Refunds of amounts  
payable to provinces**

(2) Where

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(a) the government of a province refunds, at any time, an amount to a corporation,

(b) the refund is of an amount that had been paid in satisfaction of a particular amount payable in a taxation year of the corporation, and

(c) tax was payable under subsection 204.82(5) or (6) by the corporation for a taxation year because the particular amount became payable,

the corporation is deemed to have paid at that time an amount equal to the refund on account of its tax payable under this Part for the year.

**(2) Subsection (1) applies to the 1999 and subsequent 15 taxation years.**

**45. (1) Part X.3 of the Act is amended by adding the following after section 204.84:**

**Penalty tax where  
venture capital  
business  
discontinued**

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**204.841** Where, at a particular time in a taxation year, a particular corporation that is a registered labour-sponsored venture capital corporation or a revoked corporation first discontinues its venture capital business, the particular corporation shall pay a tax under this Part for the year equal to the total of all amounts each of which is the amount in respect of a Class A share of the capital stock of the particular corporation outstanding immediately before the particular time that is determined by the formula

30

$$A \times B$$

where

A is

(a) if the original acquisition of the share was before March 6, 1996 5  
and less than five years before the particular time, 4% of the  
consideration received by the particular corporation for the issue of  
the share,

(b) if the original acquisition of the share was after March 5, 1996 10  
and less than eight years before the particular time, 1.875% of the  
consideration received by the particular corporation for the issue of  
the share, and

(c) in any other case, nil; and 15

B is

(a) if the original acquisition of the share was before March 6, 1996,  
the number obtained when the number of whole years throughout 20  
which the share was outstanding before the particular time is  
subtracted from five, and

(b) in any other case, the number obtained when the number of  
whole years throughout which the share was outstanding is 25  
subtracted from eight.

**(2) Subsection (1) applies to businesses discontinued after February 16, 1999.**

**46. (1) Subsection 204.85(1) of the Act is replaced by the following:** 30

**Dissolution of  
federally registered  
LSVCCs**

**204.85 (1)** A registered labour-sponsored venture capital corporation or a revoked corporation that has issued any Class A shares shall send written notification of any proposed amalgamation, merger, liquidation or dissolution of the corporation to the Minister at least 30 days before the amalgamation, merger, liquidation or dissolution, as the case may be. 35

**(2) Section 204.85 of the Act is amended by adding the following after subsection (2):** 40

## Amalgamations and mergers

(3) For the purposes of section 127.4, this Part and Part XII.5, where two or more corporations (each of which is referred to in this subsection as a “predecessor corporation”) amalgamate or merge to form one corporate entity (in this subsection referred to as the “new corporation”) and at least one of the predecessor corporations was, immediately before the amalgamation or merger, a registered labour-sponsored venture capital corporation or a revoked corporation,

(a) subject to paragraphs (d) and (e), the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation;

(b) where a predecessor corporation was authorized to issue a class of shares to which clause 204.81(1)(c)(ii)(C) applies, the new corporation is deemed to have received approval from the Minister of Finance to issue substantially similar shares at the time of the amalgamation or merger;

(c) each new share issued by the new corporation on the amalgamation or merger

(i) is deemed not to have been issued on the amalgamation or merger, and

(ii) is deemed to have been issued by the new corporation at the time the predecessor corporation issued the share that is replaced by the new share;

(d) the Minister is deemed to have registered the new corporation for the purposes of this Part unless

(i) the new corporation is not governed by the *Canada Business Corporations Act*,

(ii) one or more of the predecessor corporations was a registered labour-sponsored venture capital corporation the venture capital business of which was discontinued before the amalgamation or merger,

(iii) one or more of the predecessor corporations was, immediately before the amalgamation or merger, a revoked corporation,



(iv) immediately after the amalgamation or merger, the articles of the new corporation do not comply with paragraph 204.81(1)(c), or

(v) shares other than Class A shares of the capital stock of the new corporation were issued to any shareholder of the new corporation in satisfaction of any share (other than a share to which clause 204.81(1)(c)(ii)(B) or (C) applied) of a predecessor corporation;

(e) where paragraph (d) does not apply, the new corporation is deemed to be a revoked corporation;

(f) subsection 204.82(1) does not apply to the new corporation; and

(g) subsection 204.82(2) shall, in its application to the new corporation, be read without reference to the words “that begins after the end of the corporation’s start-up period (or, where the corporation has no start-up period, that begins after the time the corporation first issues a Class A share)”.

**(3) Subsection (1) applies to amalgamations, mergers, liquidations and dissolutions that occur later than 30 days after the day on which this Act is assented to.**

**(4) Subsection (2) applies to amalgamations and mergers that occur after February 16, 1999.**

**47. (1) The definition “small business investment amount” in subsection 206(1) of the Act is replaced by the following:**

**“small business  
investment amount”**

**« montant d’un  
placement dans des  
petites entreprises »**

**“small business investment amount” of a taxpayer for a month means  
the greater of**

**(a) the total of the cost amounts of all small business properties to the taxpayer at the end of the month, and**

**(b) the quotient obtained when the total of all amounts determined for each of the three preceding months, each of which is the total of the cost amounts of all small business properties to the taxpayer at the end of that preceding month, is divided by three;**

**(2) The portion of the definition “small business property” in subsection 206(1) of the Act after paragraph (d) is replaced by the following:**

where

(e) the taxpayer is a prescribed person in respect of the property, or 5

(f) throughout the period that began at the time the property was first acquired (otherwise than by a broker or dealer in securities) and ends at the particular time, the property was not owned by any person other than 10

(i) the taxpayer,

(ii) a trust governed by a particular registered retirement income fund or registered retirement savings plan if 15

(A) the taxpayer is another trust governed by a registered retirement income fund or registered retirement savings plan, and 20

(B) the annuitant under the particular fund or plan (or the spouse or former spouse of that annuitant) is also the annuitant under the fund or plan referred to in clause (A), or 25

(iii) an annuitant under a registered retirement income fund or registered retirement savings plan that governs the taxpayer, or a spouse or former spouse of that annuitant;

**(3) Subsections (1) and (2) apply to months that end after 1997.**

**48. (1) Section 211.7 of the Act is renumbered as subsection 211.7(1). 30**

**(2) Section 211.7 of the Act is amended by adding the following after subsection (1):**

**Amalgamations  
and mergers**

(2) For the purposes of this Part, where two or more corporations (each of which is referred to in this subsection as a “predecessor corporation”) amalgamate or merge to form a corporate entity deemed by paragraph 204.85(3)(d) to have been registered under Part X.3, the shares of each predecessor corporation are deemed not to be redeemed, 40

acquired or cancelled by the predecessor corporation on the amalgamation or merger.

**(3) Subsections (1) and (2) apply after February 16, 1999.**

**49. (1) The portion of subsection 211.8(1) of the Act before paragraph (a) is replaced by the following:**

5

**Disposition of  
approved share**

**211.8** (1) Where an approved share of the capital stock of a registered labour-sponsored venture capital corporation or a revoked corporation is, before the first discontinuation of its venture capital 10 business, redeemed, acquired or cancelled by the corporation less than eight years after the day on which the share was issued (other than in circumstances described in subclause 204.81(1)(c)(v)(A)(I) or (III) or clause 204.81(1)(c)(v)(B) or (D)) or any other share that was issued by 15 the person who was the shareholder immediately before the redemption, acquisition, cancellation or disposition shall pay a tax under this Part equal to the lesser of

**(2) Section 211.8 of the Act is amended by adding the following after subsection (1):**

20

**Rules of application**

(1.1) Subsections 204.8(2) and (3) and 204.85(3) apply for the purpose of subsection (1).

**(3) Subsections (1) and (2) apply to redemptions, acquisitions, 25 cancellations and dispositions that occur after February 16, 1999.**

**50. (1) Section 211.9 of the Act is replaced by the following:**

**Refund**

**211.9** The Minister may pay to an individual (other than a trust) in respect of the disposition of a share, if application for the payment has 30 been made in writing by the individual and filed with the Minister no later than two years after the end of the calendar year in which the disposition occurred, an amount not exceeding the lesser of

(a) the tax paid under this Part in respect of a disposition of the 35 share, and

(b) 15% of the net cost of the share on the original acquisition by the individual (or by a qualifying trust for the individual in respect of the share).

**(2) Subsection (1) applies to dispositions that occur after 1998.**

**51. Subsection 239(3) of the Act is replaced by the following:** 5

**Penalty on  
conviction**

(3) Where a person is convicted under this section, the person is not liable to pay a penalty imposed under section 162, 163 or 163.2 for the same contravention unless the penalty is assessed before the information 10 or complaint giving rise to the conviction was laid or made.

**52. (1) Subsection 248(1) of the Act is amended by adding the following in alphabetical order:**

“specified  
individual” 15  
« *particulier  
admissible* »

“specified individual” has the meaning assigned by subsection 120.4(1);

“split income” 20  
« *revenu fractionné* »

“split income” has the meaning assigned by subsection 120.4(1);

**(2) Subsection 248(11) of the Act is replaced by the following:**

**Compound interest** 25

(11) Interest computed at a prescribed rate under any of subsections 129(2.1) and (2.2), 131(3.1) and (3.2), 132(2.1) and (2.2), 133(7.01) and (7.02), 159(7), 160.1(1), 161(1), (2) and (11), 161.1(5), 164(3) to (4), 181.8(1) and (2) (as these two subsections read in their application to the 1991 and earlier taxation years), 185(2), 187(2) and 189(7), 30 section 190.23 (as it read in its application to the 1991 and earlier taxation years) and subsections 193(3), 195(3), 202(5) and 227(8.3), (9.2) and (9.3) of this Act and subsection 182(2) of the *Income Tax Act*, chapter 148 of the Revised Statutes of Canada, 1952 (as that subsection read in its application to taxation years beginning before 35 1986) and subsection 191(2) of that Act (as that subsection read in its application to the 1984 and earlier taxation years) shall be compounded daily and, where interest is computed on an amount under any of those



provisions and is unpaid or unapplied on the day it would, but for this subsection, have ceased to be computed under that provision, interest at the prescribed rate shall be computed and compounded daily on the unpaid or unapplied interest from that day to the day it is paid or applied and shall be paid or applied as would be the case if interest had continued to be computed under that provision after that day. 5

**(3) Subsection (1) applies to the 2000 and subsequent taxation years.**

**(4) Subsection (2) applies after 1999.**

**53. (1) Paragraph 250(1)(f) of the Act is replaced by the following:** 10

(f) was at any time in the year a child of, and dependent for support on, an individual to whom paragraph (b), (c), (d) or (d.1) applies and the person's income for the year did not exceed the amount used under paragraph (c) of the description of B in subsection 118(1) for the year; 15

**(2) Subsection (1) applies to the 1999 and subsequent taxation years except that, in its application to the 1999 taxation year, the reference to the amount used under paragraph (c) of the description of B in subsection 118(1) for the year" in paragraph 250(1)(f) of the Act, as enacted by subsection (1), shall be read as a reference to "\$7,044".** 20

**54. (1) Subsection 252(3) of the Act is amended by replacing the expression "and 148(8.1) and (8.2)" with the expression "and 148(8.1) and (8.2)", the definition "small business property" in subsection 206(1).** 25

**(2) Subsection (1) applies to the 1998 and subsequent taxation years.**



## PART 2

### EXCISE TAX ACT

**55. The *Excise Tax Act* is amended by adding the following after section 285:**

#### Definitions

5

**285.1** (1) The definitions in this subsection apply in this section.

#### “culpable conduct”

« *conduite*

*coupable* »

10

“culpable conduct” means conduct, whether an act or a failure to act, that

(a) is tantamount to intentional conduct;

15

(b) shows an indifference as to whether this Part is complied with; or

(c) shows a wilful, a reckless or a wanton disregard of the law.

20

#### “entity”

« *entité* »

“entity” includes an association, a corporation, a fund, a joint venture, an organization, a partnership, a syndicate and a trust.

25

#### “false statement”

« *faux énoncé* »

30

“false statement” includes a statement that is misleading because of an omission from the statement.

#### “gross entitlements”

« *droits à paiement* »

35

“gross entitlements” of a person at any time, in respect of a planning activity or a valuation activity of the person, means all amounts to which the person, or another person not dealing at arm’s length with the person, is entitled, either before or after that time and either absolutely or contingently, to receive or obtain in respect of the activity.

40

**“participates”****« *participer* »****“participates” includes**

(a) causing a subordinate to act or to omit information; and 5

(b) knowing of, and not making a reasonable attempt to prevent, the participation by a subordinate in an act or an omission of information. 10

**“planning activity”****« *activité de******planification* »****“planning activity” includes**

(a) organizing or creating, or assisting in the organization or creation of, an entity, a plan, a scheme or an arrangement; and 15

(b) participating, directly or indirectly, in the selling of an interest in, or the promotion of, an entity, a plan, a scheme or an arrangement. 20

**“property”****« *bien* »****“property” includes money.****“subordinate”****« *subalterne* »**

“subordinate”, in respect of a particular person, includes any other person over whose activities the particular person has direction, supervision or control whether or not the other person is an employee of the particular person or of another person, except that, if the particular person is a member of a partnership, the other person is not a subordinate of the particular person solely because the particular person is a member of the partnership. 35

**“valuation activity”****« *activité******d'évaluation* »****“valuation activity” of a person means anything done by the person in determining the value of a property or a service.**

45

**Penalty for  
misrepresentations  
in tax planning  
arrangements**

(2) Every person who makes or furnishes, or causes another person to make or furnish, a statement that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct, is a false statement that could be used by another person (in subsection (6) referred to as the “other person”) for a purpose of this Part is liable to a penalty in respect of the false statement. 10

**Amount of penalty**

(3) The penalty to which a person is liable under subsection (2) in respect of a false statement is 15

(a) if the statement is made in the course of a planning activity or a valuation activity, the greater of \$1,000 and the total of the person’s gross entitlements, at the time at which the notice of assessment of the penalty is sent to the person, in respect of the planning activity and the valuation activity; and 20

(b) in any other case, \$1,000. 25

**Penalty for  
participating in a  
misrepresentation**

(4) Every person who makes, or participates in, assents to or acquiesces in the making of, a statement to, or by or on behalf of, another person (in this subsection and subsections (5) and (6) referred to as the “other person”) that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct, is a false statement that could be used by or on behalf of the other person for a purpose of this Part is liable to a penalty in respect of the false statement. 30 35

**Amount of penalty**

(5) The penalty to which a person is liable under subsection (4) in respect of a false statement is the greater of 40

(a) \$1,000, and 45

(b) 50% of the total of all amounts each of which is

(i) if the false statement is relevant to the determination of net tax of the other person for a reporting period, the amount determined by the formula

$$A - B$$

5

where

A is the net tax of the other person for the period, and

10

B is the amount that would be the net tax of the other person for the period if the statement were not a false statement,

(ii) if the false statement is relevant to the determination of an amount of tax payable by the other person, the amount, if any, by which

(A) that tax payable

exceeds

20

(B) the amount that would be the tax payable by the other person if the statement were not a false statement, and

(iii) if the false statement is relevant to the determination of a rebate under this Part, the amount, if any, by which

(A) the amount that would be the rebate payable to the other person if the statement were not a false statement

30

exceeds

(B) the amount of the rebate payable to the other person.

### **Reliance in good faith**

35

(6) For the purpose of applying subsection (2), other than in respect of a statement made in the course of a planning activity or a valuation activity, and for the purpose of applying subsection (4), a person is not considered to have acted in circumstances amounting to culpable conduct solely because the person relied, in good faith, on information provided to the person by the other person or, because of such reliance, failed to verify, investigate or correct the information.

40

**False statements  
in respect of a  
particular  
arrangement**

(7) For the purpose of applying this section (other than subsections (4) and (5)),

(a) where a person makes or furnishes, or causes another person to make or furnish, two or more false statements, the false statements are deemed to be one false statement if the statements are made or furnished in the course of

(i) one or more planning activities that are in respect of a particular entity, a particular plan, a particular scheme or a particular arrangement, or

(ii) a valuation activity that is in respect of a particular property or a particular service; and

(b) a person is not considered to have participated in a planning activity or a valuation activity solely because the person provided clerical or secretarial services with respect to the activity.

**Valuations**

(8) A statement as to the value of a property or a service (which value is in this subsection referred to as the “stated value”) made by the person who opined on the stated value, or by a person engaged in an activity described in paragraph (b) of the definition “planning activity” in subsection (1), is deemed to be a statement that the person would reasonably be expected to know, but for circumstances amounting to culpable conduct, is a false statement if the stated value is

(a) less than the product obtained when the prescribed percentage for the property or service is multiplied by the fair market value of the property or service; or

(b) greater than the product obtained when the prescribed percentage for the property or service is multiplied by the fair market value of the property or service.

**Exception**

(9) Subsection (8) does not apply to a person in respect of a statement as to a value if the person establishes that that stated value was reasonable in the circumstances and the statement was provided in good faith.



## Special rules

(10) For the purpose of applying this section,

(a) where a person is assessed a penalty under subsection (2) the amount of which is based on the person's gross entitlements at any time in respect of a planning activity or a valuation activity and another assessment of the penalty is made at a later time,

(i) if the person's gross entitlements in respect of the activity are greater at that later time, the assessment of the penalty made at that later time is deemed to be an assessment of a separate penalty, and

(ii) in any other case, the notice of assessment of the penalty sent before that later time is deemed not to have been sent; and

(b) a person's gross entitlements at any time in respect of a planning activity, or a valuation activity, in the course of which the person makes or furnishes, or causes another person to make or furnish, a false statement shall exclude the total of all amounts each of which is the amount of a penalty (other than a penalty the assessment of which is void because of subsection (11)) determined under paragraph (3)(a) in respect of the false statement for which notice of assessment was sent to the person before that time.

## Assessment void

(11) For the purposes of this Part, if an assessment of a penalty under subsection (2) or (4) is vacated, the assessment is deemed to be void.

## Maximum penalty

(12) A person who is liable at any time to a penalty under both subsections (2) and (4) in respect of the same false statement is liable to pay a penalty that is not more than the greater of

(a) the total amount of the penalties to which the person is liable at that time under subsection (2) in respect of the statement, and

(b) the total amount of the penalties to which the person is liable at that time under subsection (4) in respect of the statement.

**56. Subsection 327(3) of the Act is replaced by the following:**

**Penalty on  
conviction**

(3) A person who is convicted of an offence under this section is not liable to pay a penalty imposed under any of sections 283 to 285.1 for the same evasion or attempt unless a notice of assessment for that penalty was issued before the information or complaint giving rise to the conviction was laid or made. 5

## PART 3

## BUDGET IMPLEMENTATION ACT, 1999

57. (1) Paragraph 36(7)(a) of the *Budget Implementation Act, 1999*, chapter 26 of the Statutes of Canada, 1999 is replaced by the following:

5

(a) the references to “\$955”, “\$755” and “\$680” in paragraphs (a) and (b) of the description of F in subsection 122.61(1) of the Act, as enacted by subsection (2), shall be read as references to “\$785”, “\$585” and “\$510”, respectively; and

10

(2) Subsection (1) is deemed to have come into force on June 17, 1999.

*Conditional Amendment*

**58. If Bill C-88, introduced in the first session of the thirty-sixth Parliament and entitled *An Act to amend the Excise Tax Act, a related Act, the Cultural Property Export and Import Act, the Customs Act, the Excise Act, the Income Tax Act and the Tax Court of Canada Act*, is assented to and section 56 of this Act comes into force before or on the same day as subsection 87(2) of that Act, that subsection is repealed.**

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## **Explanatory Notes**

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## PREFACE

These explanatory notes describe proposed amendments to the *Income Tax Act* and the *Excise Tax Act*. These explanatory notes describe these amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable Paul Martin  
Minister of Finance

These explanatory notes are provided to assist in an understanding of proposed amendments to the *Income Tax Act* and *Excise Tax Act*. These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.



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## **EXPLANATORY NOTES TO DRAFT AMENDMENTS 1999 BUDGET INCOME TAX PROPOSALS**

### **Clause 1**

#### **Income from Business or Property – Deductions**

ITA

20(1)(*ww*)

Section 20 of the *Income Tax Act* provides rules relating to the deductibility of certain outlays, expenses and other amounts in computing a taxpayer's income for a taxation year from a business or from property.

New paragraph 20(1)(*ww*) of the Act provides for the deduction, in computing a taxpayer's income for a taxation year, of an amount equal to the taxpayer's split income for the year. This provision, which is consequential on the introduction of the tax on split income, ensures that income that is taxed as split income is not also taxed as regular income.

For information on the tax on split income, see the commentary on new section 120.4.

This amendment applies to the 2000 and subsequent taxation years.

### **Clause 2**

#### **Amounts Included in Income – Exception for Split Income**

ITA

56(5)

Subsections 56(2), (4) and (4.1) of the Act provide rules that include amounts in a taxpayer's income in circumstances where the taxpayer has transferred property or a right to income, or made a loan, to another person.

New subsection 56(5) of the Act provides that subsections 56(2), (4) and (4.1) do not apply in respect of amounts included in any taxpayer's split income. This provision, which is consequential on the introduction of the tax on split income, ensures that amounts taxed as split income in the hands of a minor child are not also attributed to another person.

For information on the tax on split income, see the commentary on new section 120.4.

This amendment applies to the 2000 and subsequent taxation years.

### **Clause 3**

#### **Other Deductions**

##### **ITA 60(l)**

Paragraph 60(l) of the Act allows a deduction to an individual who receives specified amounts of retirement income and transfers a designated portion of such income to a registered retirement savings plan (RRSP), a registered retirement income fund (RRIF) or to acquire a specified annuity. The deadline under paragraph 60(l) for the transfer is 60 days after the end of the taxation year in which the retirement income is received.

Paragraph 60(l) is amended to allow for the extension of this deadline for a taxpayer, where the extension is acceptable to the Minister of National Revenue. This amendment applies to the 1999 and subsequent taxation years.

As a result of an amendment that is being made to the definition "refund of premiums" in subsection 146(1), a consequential transitional rule is provided for the application of paragraph 60(l) for the 1996 to 1998 taxation years. If, as a result of the amendment to the definition "refund of premiums", a distribution from an RRSP or RRIF is included (or deemed by subsection 146(8.1) or 146.3(6.1) to be included) in computing a taxpayer's income for a taxation year, the transitional rule allows for an offset in the same year by the amount of a transfer to which paragraph 60(l) applies. This transfer must be

made on or before February 29, 2000 (or a later day acceptable to that Minister). For further detail, see the commentary on the amendments to the definition “refund of premiums” in subsection 146(1).

## **Clause 4**

### **Reserve for Debt Forgiveness for Resident Individuals**

ITA

61.2

Section 61.2 of the Act provides a deduction to individuals resident in Canada who might otherwise face financial hardship as a consequence of an income inclusion under subsection 80(13), which in certain circumstances includes an amount in the income of an individual whose indebtedness has been forgiven. The amount of the deduction is based in part on the individual's income for the year.

The section is amended to provide that an individual's “income” for this purpose is determined without reference to the deduction provided by new paragraph 20(1)(ww) in respect of split income.

For information on the tax on split income, see the commentary on new section 120.4.

This amendment applies to the 2000 and subsequent taxation years.

## **Clause 5**

### **Child Care Expenses**

ITA

63(3)

“eligible child”

Subsection 63(3) of the Act contains the definition “eligible child” for the purpose of the child care expense deduction. One of the criteria used in determining the eligibility of a child is whether the child's

income exceeds the amount of income that can be earned on a tax-free basis.

This definition is amended to reflect the increase of the basic personal amount from \$6,456 to \$6,794 for 1999 and to \$7,131 (partially indexed) starting in 2000, and on the two-year phase-out of the \$500 supplementary amount provided under paragraph 118(1)(b.1) of the Act.

This amendment applies to the 1999 and subsequent taxation years. For 1999, the amount of income that can be earned on a tax-free basis is \$7,044 (i.e., \$6,794 plus 50% of the \$500 supplementary amount). Starting in 2000, that amount will be equal to the \$7,131 (partially indexed) basic personal amount.

For information on the changes to the personal amounts, see the commentary on subsection 118(1) of the Act.

## **Clause 6**

### **Attribution Rules – Transfers and Loans to Corporations**

ITA

74.4(2)

Subsection 74.4(2) of the Act requires an individual who transfers or loans property to a corporation (other than a small business corporation) to include in income the amount by which interest at the prescribed rate on the loan exceeds the total of any interest actually received on the loan and  $\frac{5}{4}$  of any dividends received on shares issued for the transfer, where one of the main purposes of the transfer can reasonably be considered to be to reduce the income of the individual and to benefit a person who is a designated person in respect of the individual.

This subsection is amended to further reduce the amount required to be included in the individual's income by  $\frac{5}{4}$  of all taxable dividends received by the designated person where those dividends can reasonably be considered to be part of the benefit sought to be conferred and are included in the designated person's split income.

For information on the tax on split income, see the commentary on new section 120.4.

This amendment applies to the 2000 and subsequent taxation years.

## **Clause 7**

### **Exception from Attribution Rules**

ITA  
74.5(13)

Subsections 74.1(1), 74.1(2), 74.3(1) and 75(2) of the Act (and section 74 of the Act as it applies to transfers made before May 23, 1985) provide attribution rules in respect of property transferred by an individual to a spouse, to another individual under the age of 18 years, or to a trust. Where the conditions of these provisions are met, these rules attribute income from transferred property back to the transferor.

New subsection 74.5(13) of the Act provides an exception to these rules for amounts that are taxed as split income. This provision ensures that amounts taxed as split income in the hands of a minor child are not also attributed to a parent (or other transferor).

For information on the tax on split income, see the commentary on new section 120.4.

This amendment applies to the 2000 and subsequent taxation years.

## **Clause 8**

### **Exempt Income**

ITA  
81(1)(g.3)

Section 81 of the Act lists various amounts that are excluded in computing a taxpayer's income.



New paragraph 81(1)(g.3) applies to the trust established under the 1986-1990 Hepatitis C Settlement Agreement. This Agreement is to be executed by the federal, provincial and territorial governments in order to provide compensation for certain individuals infected with the Hepatitis C virus. Assuming that no contribution, other than contributions provided for under the Agreement, is made before the end of a taxation year of that trust, the effect of paragraph 81(1)(g.3) is to completely exempt from taxation the trust's total income for the year.

This amendment applies to the 1999 and subsequent taxation years.

## **Clause 9**

### **Trusts**

ITA  
108

Section 108 of the Act sets out certain definitions and rules concerning the taxation of trusts and their beneficiaries.

### **Definitions**

ITA  
108(1)

“preferred beneficiary”

Subsection 108(1) of the Act defines the expression “preferred beneficiary”. Under the preferred beneficiary election in subsection 104(14) of the Act, certain amounts of income otherwise taxable at the trust level can be allocated to a preferred beneficiary. In general, individuals must qualify for the disability tax credit in order to be a preferred beneficiary. However, adults not qualifying for the disability tax credit who are nevertheless dependent on another person because of mental or physical infirmity can qualify as preferred beneficiaries if their income (determined before allocations under the preferred beneficiary election) is below \$6,456.

The \$6,456 threshold is increased to \$6,956 for the 1998 taxation year to reflect the \$500 supplementary amount that was introduced as part of the 1998 budget.

The definition “preferred beneficiary” is further amended to increase the \$6,956 threshold to \$7,044 for the 1999 taxation year and to \$7,131 (partially indexed) for the 2000 and subsequent taxation years. These amendments to the definition are consequential on the increase of the basic personal amount from \$6,456 to \$6,794 for 1999 and to \$7,131 (partially indexed) starting in 2000, and on the two-year phase-out of the \$500 supplementary amount provided under paragraph (b.1) of the description of B in subsection 118(1) of the Act.

For information on the changes to the personal amounts, see the commentary on subsection 118(1) of the Act.

### **Nature of Income Retained**

ITA  
108(5)

Subsection 108(5) of the Act provides that the nature of income or deductions flowing through a trust to a beneficiary of the trust is retained only where the Act specifically so provides. This rule does not, however, affect the attribution rules in subsection 56(4.1) and in sections 74.1 to 75 of the Act.

The amendment to subsection 108(5) is consequential on the introduction of the tax on split income. It adds new section 120.4 (tax on split income) and new subsection 160(1.2) (joint liability of certain parents for payment of a child's tax on split income) to the list of provisions that are not affected by the rule in subsection 108(5). That is to say, for the purpose of these new provisions, the allocations by the trust do retain their character.

For information on the tax on split income, see the commentary on new section 120.4.

This amendment applies to the 2000 and subsequent taxation years.

## Clause 10

### Lump-sum Payments

ITA

110.2

For individuals, income from most sources is taxable in the year in which it is received. As a result, individuals are generally taxable on retroactive lump-sum payments in the year they are received, even though a significant portion may relate to prior years. Due to the progressive rate structure of the income tax system, the tax payable on those lump-sum payments may, therefore, be significantly higher than it would have been if payments had been received and taxed on an on-going basis from the date of eligibility.

New section 110.2 of the Act provides relief in these circumstances and allows an individual (other than a trust) to deduct in computing taxable income for a taxation year, the specified portion of a qualifying amount received by the individual in that year.

Subsection 110.2(1) defines three terms used for the purpose of this new deduction: “eligible taxation year”, “qualifying amount” and “specified portion”.

An eligible taxation year is, essentially, a preceding taxation year in respect of which a lump sum payment is received by an individual. To be an eligible taxation year, the year must be subsequent to 1977 and be a year throughout which the individual was resident in Canada. Furthermore, a calendar year in which the individual became a bankrupt or that was included in the individual’s averaging period for the purpose of the former block averaging provisions, that were available to individuals carrying on a farming or fishing business, is not an eligible taxation year.

A qualifying amount is the principal portion of certain amounts included in income. Those amounts are: spousal or child support amounts, superannuation or pension benefits otherwise payable on a periodic basis, employment insurance benefits and benefits paid under wage loss replacement plans. Also included is the income received from an office or employment (or because of a termination of an

office or employment) under the terms of a court order or judgment, an arbitration award or in settlement of a lawsuit.

The specified portion, in relation to an eligible taxation year, of a qualifying amount is the portion of the qualifying amount that relates to that year, provided that the individual's eligibility to receive that portion existed in that year.

New subsection 110.2(2) provides a deduction in computing an individual's taxable income for a taxation year in which the individual received a qualifying amount. This deduction is equal to the total of the specified portions of the qualifying amount for all preceding years that are eligible taxation years in relation to the qualifying amount. To be deductible, that total must be \$3,000 or more. The tax payable on the amount deducted under subsection 110.2(2) is calculated under new section 120.31. This calculation is explained in the commentary on that section.

New section 110.2 applies to lump-sum payments received after 1994, other than amounts in respect of which income tax has been remitted under the *Financial Administration Act*.

## **Clause 11**

### **Forward Averaging**

ITA

110.4

Section 110.4 of the Act provides part of the forward averaging mechanism, which system lapsed at the end of 1997. Consequently, this section is repealed for the 1998 and subsequent taxation years.

## **Clause 12**

### **Losses Deductible – Definitions**

ITA

111(8)

Section 111 of the Act establishes the extent to which amounts may be deducted in computing a taxpayer's taxable income for a taxation year in respect of losses of other taxation years.

The definitions “farm loss” and “non-capital loss” in subsection 111(8) are amended to remove the references to subsection 110.4(2) relating to the now lapsed forward averaging mechanism, which is being repealed. For information on the repeal of section 110.4, see the commentary on that section.

These amendments apply to the 1998 and subsequent taxation years.

## **Clause 13**

### **Order of Applying Provisions**

ITA

111.1

Section 111.1 of the Act provides for the order in which certain deductions must be taken in computing taxable income.

This section is amended to eliminate the reference to subsection 110.4(2), which is being repealed. For information on the repeal of section 110.4, see the commentary on that section.

This amendment applies to the 1998 and subsequent taxation years.



## Clause 14

### Non-Resident Funds with Canadian Service Providers

ITA  
115.2

New section 115.2 of the Act is an interpretive rule that applies to non-resident investment and pension funds. The rule clarifies that such a fund is not considered to be carrying on business in Canada solely by reason of engaging a Canadian firm to provide certain investment management and administration services, provided that certain conditions are met. The rule is not intended to create any implication as to whether or not a business is being carried on in Canada in cases where the conditions for the application of the rule are not satisfied.

### Definitions

ITA  
115.2(1)

Subsection 115.2(1) of the Act sets out definitions of terms used in the interpretive rule in new section 115.2 relating to non-resident funds that engage Canadian service providers.

“Canadian service provider”

The expression “Canadian service provider” means a corporation resident in Canada, a trust resident in Canada or a Canadian partnership (defined in subsections 248(1) and 102(1) of the Act as being a partnership all of the members of which are resident in Canada).

“designated services”

The definition “designated services” lists the services that may be provided by a Canadian service provider to a non-resident fund within the scope of the clarifying rule. While the rule contemplates that the Canadian service provider in question is responsible for providing the services to the non-resident fund, some or all of the

services might actually be performed by another party (in Canada or elsewhere) under sub-contract to the Canadian service provider.

Paragraph (a) of the definition provides that designated services include investment management and investment advice with respect to qualified investments. Management and advice include gathering, analyzing, and communicating the full range of information on which decisions regarding the buying, holding, and selling of qualified investments is based. This information includes both information about specific qualified investments, and more general information relating to market conditions relevant to decision-making regarding qualified investments. Management and advice include recommendations concerning the buying, holding and selling of investments, and the making of decisions on those matters in cases where the service provider is given discretionary authority by the non-resident fund.

Paragraph (b) of the definition provides that designated services include purchasing and selling qualified investments, which is intended to encompass both the giving of instructions with respect to purchasing and selling, and the execution of the purchases and sales as, for example, by a securities dealer. The making of agreements relating to the purchase and sale of investments is also covered. Designated services also include the exercising of rights incidental to ownership of qualified investments, such as voting at meetings of shareholders, nominating members for the board of directors of a company in which shares are held, and entering into and carrying out agreements with respect to such rights, such as shareholder agreements.

Paragraph (c) of the definition provides that designated services includes investment administration services, commonly referred to as “back office” functions. These are clerical and administrative functions incidental to the operation of an investment portfolio. A detailed but non-exclusive list of such services is set out in the paragraph.

“investment turnover rate”

The “investment turnover rate” is a measure of the frequency with which a fund turns over its investments in a year. The rate is measured by a formula. All amounts referred to in the formula are

expressed in the currency in which the accounts of the fund are ordinarily prepared.

The numerator of the formula is the excess of dispositions over net redemptions. In the numerator, “dispositions” refers to the amount received by the fund during the year from dispositions of property. While property is not restricted to qualified investments, it excludes investments that are redeemed at maturity or redeemed unilaterally prior to maturity by their issuers without the consent of their holders.

The second term in the numerator, “net redemptions,” refers, in the case of an investment fund, to the excess for the year of the amount of money paid out to investors in respect of the redemption or repurchase of units over the amount of new money received from investors. In the case of a pension fund, the term refers to the excess for the year of benefits paid out by the fund over contributions received.

The denominator of the formula is the “average investments” of the fund for the year, calculated at monthly valuation dates, which may be chosen by the fund.

#### “non-resident investment fund”

A “non-resident investment fund” is a non-resident corporation, a non-resident trust or a partnership no member of which is resident in Canada. The sole undertaking of the fund must be the investing of its funds in property. This requirement is similar to that in the definitions of “mutual fund corporation” in subsection 131(8) of the Act and “mutual fund trust” in subsection 132(6) of the Act.

#### “non-resident pension fund”

A “non-resident pension fund” is a non-resident corporation or trust of which the principal purpose is to provide pension or other employee benefits. Such a fund must relate principally to employment exercised outside Canada, and it must not be reasonable to expect that any person will receive from the fund benefits that exceed 20% of the total value of property held by fund. This latter requirement, which parallels the 20% interest limitation in the definition “qualified non-resident fund”, ensures that the fund is a pool of investments held on behalf of a number of beneficiaries.

“promoter”

A “promoter” of a fund is one who initiates or directs the founding, organization or substantial reorganization of the fund, or one affiliated with such a person.

“qualified investment”

The expression “qualified investment” means any property other than real property, Canadian resource property, and timber resource property, or a corporate share or a trust or partnership interest the value of which is substantially derived from one or more such properties. The term also encompasses any interest, option or right in respect of the aforementioned types of property.

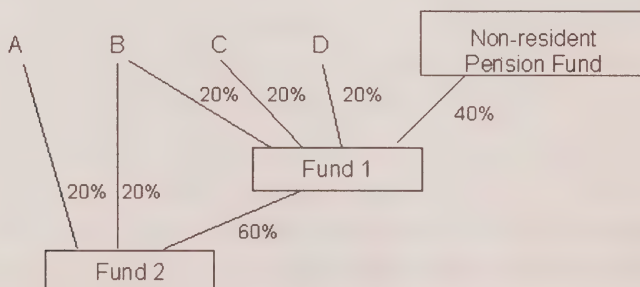
“qualified non-resident fund”

A “qualified non-resident fund” is either a non-resident pension fund, or a non-resident investment fund in which no person or partnership (other than another qualified non-resident fund) holds an interest worth more than 20% of the total value of all interests in the fund. For this purpose, holdings include both those held directly and those held indirectly through one or intermediary entities. In applying this limitation, an interest holder is deemed to hold the interests of all holders affiliated with it.

Indirect holdings are illustrated by the following example:

**EXAMPLE**

(Letters designate individuals, none of whom are affiliated. Fund 1 and Fund 2 are “non-resident investment funds”.)





*No interest-holder in Fund 1 holds an interest worth more than 20% of the total value of interests, with the exception of Non-resident Pension Fund, which we assume qualifies as a “non-resident pension fund”. As a result, Fund 1 is a “qualified non-resident fund”.*

*No interest-holder in Fund 2 (other than Fund 1, a qualified non-resident fund) has a direct interest worth more than 20% of the total value of interests. However, in addition to B's direct interest of 20%, B has an indirect interest of 12% through Fund 1 (20% of Fund 1's 60% interest) for a total of 32%. Since the fair market value of B's direct and indirect interests exceeds 20%, Fund 2 is not a “qualified non-resident fund”.*

## **Not Carrying on Business in Canada**

ITA

115.2(2)

New subsection 115.2(2) is an interpretive rule that applies to non-resident investment and pension funds. It applies only for the purposes of subsection 115(1) and Part XIV (dealing with the “branch tax”) of the Act. The rule clarifies that, provided certain conditions are met, a qualified non-resident fund is not considered to be carrying on business in Canada solely by reason of engaging a Canadian service provider to provide designated investment management and administrative services in relation to qualified investments. The rule is not intended to create any implication as to whether or not a business is being carried on in Canada in circumstances where the conditions for the application of the rule are not satisfied.

There are three conditions for the application of the rule. First, the non-resident fund must comply with a prohibition on the marketing and sale of fund interests to Canadian residents. Specifically, the fund must not have directed any promotion of investments in the fund principally at persons that the fund would have known upon reasonable enquiry to be Canadian residents.

The second condition supports the first. The fund must not have filed any prospectus or other offering document with a Canadian securities



regulator in order to permit distribution of units in the fund to Canadian residents.

The third condition consists of two alternative requirements, only one of which must be met. The first is that the Canadian service provider deal with the fund and the fund's promoters at arm's length.

If the arm's length test is not met, then the fund must meet the alternative test – that its investment turnover rate for the year is no more than three. This test is based on an implicit presumption, made only for the purpose of this rule, that if the fund's rate of investment turnover is not high, the fund's investment activity is primarily passive in nature and does not constitute a business.

This rule applies to non-resident funds for the 1999 and subsequent taxation years.

## **Clause 15**

### **Tax Payable Under Part I**

ITA

117

Section 117 of the Act sets out the rates of tax applicable to individuals.

ITA

117(1)

Subsection 117(1) of the Act, which determines the computation of the tax payable under Part I by an individual, generally without reference to the alternative minimum tax, is amended to delete the reference to section 120.1, which is being repealed.

Subsection 117(1) is also amended to change the reference to paragraph (b) of the definition “tax otherwise payable under this Part” in subsection 120(4) to a reference to subparagraph (a)(ii) of that definition as a consequence of the amendment to that definition. For information on the amendment to the definition “tax otherwise

payable” in subsection 120(4) and the repeal of section 120.1, see the commentary on those provisions.

These amendments apply to the 1998 and subsequent taxation years except that, in its application to the 1998 and 1999 taxation years, the reference in subsection 117(1) to subparagraph (a)(ii) is to be read as a reference to paragraph (b).

#### ITA 117(6)

Subsection 117(6) of the Act provides the authority for the use of a tax table to assist individuals to compute their federal tax liability before claiming personal credits and other credits to which they may be entitled. This subsection is repealed because the tax table is no longer provided. The income tax return now provides for the required calculations in the return.

This amendment applies to the 1998 and subsequent taxation years.

### **Clause 16**

#### **Annual Adjustment of Deductions and Other Amounts**

#### ITA 117.1(1) and (2)

Subsection 117.1(1) of the Act provides for the indexing of various amounts, including the amounts on which the personal tax credits are based. Subsection 117.1(2) provides for the partial indexing of the income threshold used in calculating the spousal (spouse and equivalent-to-spouse) tax credits.

The wording of subsection 117.1(1) is simplified, in part as a consequence of the amendment being made to the definition “preferred beneficiary” in subsection 108(1) of the Act. This amendment applies to the 2001 and subsequent taxation years.

Subsection 117.1(2) of the Act is repealed as a consequence of the increase of the basic and spousal amounts, effective for the 1999 and subsequent taxation years.

**Clause 17****Personal Tax Credits**

ITA

118

Section 118 of the Act provides for the calculation of various personal tax credits. These include the basic, spousal, infirm dependant, age and pension tax credits.

**Subclauses 17(1) and (2)**

ITA

118(1)B(a) and (b)

Paragraph (a) of the description of B in subsection 118(1) of the Act provides for a basic personal amount of \$6,000 and, for individuals who support a dependent spouse, a maximum spouse amount of \$5,000 where the spouse's income does not exceed \$500.

Paragraph (b) of that description provides for an equivalent-to-spouse amount (using the same amounts as for the spouse credit) in respect of certain wholly dependent persons. As a result of indexing, the \$6,000, \$5,000 and \$500 amounts are currently set at \$6,456, \$5,380 and \$538, respectively.

Those amounts are being changed to \$6,794, \$5,718 and \$572, respectively for 1999, and to \$7,131, \$6,055 and \$606, respectively, for 2000 and subsequent years. The current partial indexing provisions will apply to those amounts after 2000.

**Subclauses 17(3) and (4)****Supplementary Amount**

ITA

118(1)B(b.1)

Paragraph (b.1) of the description of B in subsection 118(1) of the Act provides for a \$500 supplement to the basic personal and spousal amounts. This supplementary amount is phased out at a rate of 4 per

cent of income over \$6,956. This supplementary amount is being replaced with a \$675 increase of the basic personal and spousal amounts.

The repeal of the supplementary amount becomes effective with the 2000 taxation year. For 1999, the supplementary amount will be equal to one-half of the supplement that would be otherwise determined for the year, up to a maximum of \$250.

### **Subclause 17(5)**

#### **Basic Personal Amount**

ITA

118(1)B(c)

Paragraph (c) of the description of B in subsection 118(1) of the Act provides for a \$6,456 basic personal amount for individuals who are not entitled to a spousal (spouse or equivalent-to-spouse) tax credit.

The paragraph is amended to increase the basic personal amount to \$6,794 for 1999 and to \$7,131 (partially indexed) starting in 2000.

This amendment applies to the 1999 and subsequent taxation years.

### **Subclause 17(6)**

#### **Infirm Dependant Amount**

ITA

118(1)B(d)

Paragraph (d) of the description of B in subsection 118(1) of the Act provides to an individual a tax credit in respect of a person who is 18 years of age or older and dependent on the individual because of a mental or physical infirmity. The credit is calculated as 17% of \$2,353, and is reduced by 17% of the amount by which the dependant's income exceeds \$4,103. Thus, the maximum credit available is \$400, which is reduced to zero when the dependant's income reaches \$6,456.

The amendment to the paragraph increases from \$4,103 to \$4,778 the income threshold at which the credit begins to be reduced. This \$675 increase reflects the corresponding increase (i.e., from \$6,456 to \$7,131) of the basic personal amount.

This amendment applies to the 1999 and subsequent taxation years except that, for 1999, the income threshold at which the credit begins to be reduced will be set at \$4,441.

## **Clause 18**

### **Medical Expense Credit**

ITA  
118.2

Section 118.2 of the Act provides rules for determining the amount that may be claimed as a tax credit in respect of an individual's medical expenses.

ITA  
118.2(1)D(b)

Subsection 118.2(1) of the Act provides for the calculation of the amount that may be deducted from an individual's tax payable in respect of medical expenses. When an individual claims medical expenses in respect of a dependant (other than the individual's spouse) whose income is in excess of \$6,956, the amount of eligible medical expenses is reduced by 68% of the excess.

The amendment to paragraph (b) of the description of D in subsection 118.2(1) is consequential on the increase from \$6,456 to \$7,131 of the basic personal amount and the two-year phase-out of the \$500 supplementary amount. This means that the 68% reduction will apply to the portion of the dependant's income that is in excess of \$7,044 for 1999 and in excess of \$7,131 (partially indexed) starting in 2000.

This amendment applies to the 1999 and subsequent taxation years.



ITA

118.2(2)(b.1)

Paragraph 118.2(2)(b.1) of the Act allows amounts paid as remuneration for part-time attendant care in Canada for an individual who has a severe and prolonged mental or physical impairment to qualify, up to a maximum of \$10,000 (\$20,000 if the individual has died in the year), as medical expenses, provided certain other conditions are met. Attendant care expenses may, in certain circumstances, qualify for tax assistance under various provisions of the Act, such as those relating to child care expenses, attendant care expenses for working individuals and nursing home fees.

Subparagraph 118.2(2)(b.1)(ii) ensures that no part of the remuneration paid for attendant care is claimed under more than one such provision. The subparagraph is amended to include new paragraph 118.2(2)(b.2) as such a provision.

A description of new paragraph 118.2(2)(b.2) is provided in the commentary below.

The amendment to subparagraph 118.2(2)(b.1)(ii) applies to the 1999 and subsequent taxation years.

ITA

118.2(2)(b.2)

Subsection 118.2(2) of the Act contains a list of expenditures that qualify as eligible medical expenses. New paragraph 118.2(2)(b.2) adds to this list amounts paid on account of remuneration to persons providing care and supervision in a group home maintained and operated exclusively for the benefit of individuals with severe mental or physical impairments who are eligible for the disability tax credit.

This amendment applies to the 1999 and subsequent taxation years.

ITA

118.2(2)(l.9) and (l.10)

Subsection 118.2(2) of the Act sets out the expenses that may be included in the computation of an individual's medical expense credit.

New paragraph 118.2(2)(l.9) adds to the list of eligible medical expenses remuneration paid for therapy administered to an individual with a severe mental or physical impairment who is eligible for the disability tax credit. The therapy must be prescribed by, and administered under the general supervision of, a medical doctor (or a psychologist in the case of a mental impairment, or an occupational therapist in the case of a physical impairment).

New paragraph 118.2(2)(l.10) adds to the list of eligible medical expenses remuneration paid for tutoring services for individuals with learning disabilities (or a mental impairment). In order for the remuneration to qualify as an eligible medical expense, the need for tutoring services must be certified in writing by a medical practitioner and the tutor has to be a person whose occupation is to offer tutoring services to individuals to whom the tutor is not related.

These amendments apply to the 1999 and subsequent taxation years.

## **Clause 19**

### **Transfer of Unused Credits to Spouse**

ITA  
118.8

Section 118.8 of the Act governs the transfer to a spouse of certain unused personal tax credits. The credits that may be transferred are the tuition and education tax credits and the age, pension and disability tax credits.

Subsection 118.8 of the Act is amended to remove the reference to paragraph (b.1) of the description of B in subsection 118(1) of the Act as a consequence of the two-year phase-out of the \$500 supplementary amount provided under that paragraph.

This amendment applies to the 2000 and subsequent taxation years.

## Clause 20

### Income Not Earned in a Province

ITA

120

Section 120 of the Act provides for the payment by an individual of an additional tax in respect of the portion of the individual's income that is not earned in a province and allows a tax reduction (Quebec abatement) to an individual in respect of income earned in the Province of Quebec.

ITA

120(3)

Subsection 120(3) of the Act defines the expression “the individual's income for the year” as used in the application of the 52% tax on the income not earned in a province and in the application of the amount deemed paid in prescribed manner related to the 16.5% Quebec abatement.

New paragraph (c) excludes from the determination of an individual's income for the year for this purpose the deduction provided under new paragraph 20(1)(ww) (split income) in order to apply the 52% tax on the income not earned in a province, and the 16.5% Quebec abatement, on the taxpayer's income before deducting the amount taxed as split income.

For information on the tax on split income, see the commentary on new section 120.4.

This amendment applies to the 2000 and subsequent taxation years.

ITA

120(4)

Subsection 120(4) of the Act defines the expression “tax otherwise payable under this Part”, which is relevant in determining the amount of additional tax that is payable by an individual in respect of income that was not earned in a province. The expression is also relevant in determining the special Quebec abatement.

The amendment of this definition is consequential on the introduction of the new tax on split income. As amended, an individual's "tax otherwise payable under this Part" for a taxation year is the total of two amounts. One amount is the greater of the individual's minimum tax and the regular tax for the year without taking into account the individual's tax on split income and the dividend tax credit related to that split income and, as in prior years, without taking into account certain other deductions. The second amount is the individual's tax for the year on split income, less the dividend tax credit related to that split income.

This amendment ensures that both the additional tax payable on income that is not earned in a province and the special Quebec abatement include the tax on split income. The amendment also ensures that the tax credit related to dividends included in computing the split income is not deducted twice.

For information on the tax on split income, see the commentary on new section 120.4.

This amendment applies to the 2000 and subsequent taxation years.

## **Clause 21**

### **Forward Averaging Credit**

#### **ITA 120.1**

Section 120.1 of the Act provides a deduction in computing tax payable where an amount that was forward averaged (deducted in computing taxable income) in a prior year is included in taxable income in the current year.

This section lapsed at the end of 1997 and is, therefore, repealed for the 1998 and subsequent taxation years.

## **Clause 22**

### **Minimum Tax Carry-Over**

ITA

120.2

Section 120.2 of the Act provides for the carry-over of additional taxes paid for previous taxation years under the minimum tax provisions.

ITA

120.2(1) and (3)

Subsection 120.2(1) of the Act is amended to remove the reference to section 120.1 relating to the now lapsed forward averaging mechanism, which is being repealed, and to add a reference to new subparagraph 120.4(2) in order to exclude the tax on split income from the calculation of an individual's tax payable from which an amount of minimum tax carry-over may be claimed.

Subparagraph 120.2(1)(b)(i) and paragraph 120.2(3)(b) of the Act are amended to provide that the determination of an individual's tax payable under this Part, against which the minimum tax may be claimed, is made without taking into account the individual's tax on split income. Those provisions are also amended to remove the reference to section 120.1, related to the now lapsed forward averaging mechanism, and subsection 117(6), related to the historical use of tax tables, which are being repealed.

These amendments apply to the 2000 and subsequent taxation years.

## **Clause 23**

### **Lump-sum Payments**

ITA

120.31

New section 120.31 of the Act provides for the calculation of an individual's tax payable for a taxation year on that portion of a lump-



sum payment that has been deducted under subsection 110.2(2) in computing the individual's taxable income for that year. This tax is the total of the additional taxes that would be triggered for each relevant preceding year if the portion of the lump-sum payment that relates to that preceding year were added to the individual's taxable income for that year. The terms "eligible taxation year", "qualifying amount" and "specified portion", which are used in new section 120.31, are defined in subsection 110.2(1) and explained in the commentary on that subsection.

A notional amount of interest (using the rate of interest on tax refunds applicable to the relevant period) is added to the additional tax computed for each relevant preceding year (other than the year preceding the year of receipt of the lump-sum payment) to take into account the fact that the calculation of the tax on the lump-sum payment should reflect not only the additional tax that would have been payable had the payment been received on an on-going basis, but also the fact that this additional tax was not paid during those preceding years. The notional amount of interest (which is not considered to be interest for any purpose of the Act) is computed for the period that begins on May 1 of the year following the relevant preceding year and that ends immediately before the year in which the lump-sum payment is received.

New section 120.31 applies to the 1995 and subsequent taxation years.

## **Clause 24**

### **Tax on Split Income**

#### **ITA 120.4**

New section 120.4 of the Act introduces a special 29% tax applicable to certain passive income of individuals under the age of 18 years.

Generally, the types of income which are taxed under this new measure are:

- taxable dividends and other shareholder benefits on unlisted shares of Canadian and foreign companies (received directly or through a trust or partnership); and
- income from a partnership or trust where the income is derived by the partnership or trust from the business of providing goods or services to a business carried on by a relative of the child or in which the relative participates.

The only amounts deductible from this tax are the dividend tax credit and the foreign tax credit that are in respect of amounts included in the split income.

## **Definitions**

ITA  
120.4(1)

Subsection 120.4(1) of the Act defines various expressions for the purposes of the income-splitting tax.

“excluded amount”

This expression describes income that is excluded from split income. There are two types of income that qualify as an excluded amount. The first is income from property inherited by an individual from a parent of the individual. The second is income from property inherited by an individual from anyone, if the individual is either a full-time student enrolled at a post-secondary educational institution as defined in subsection 146.1(1) of the Act, or is eligible for the disability tax credit, in the year in which the income is required to be reported.

“specified individual”

This expression describes taxpayers who are subject to the tax on split income. A specified individual generally means an individual who had not attained the age of 17 years before the year, is resident in Canada throughout the year, and has a parent who is resident in Canada at any time in the year.

### “split income”

This expression describes the type of income that is subject to the new tax on split income under this section. Split income of an individual includes all amounts (other than excluded amounts) required to be included in the individual's income in respect of

- taxable dividends (other than dividends received on listed shares or on shares of the capital stock of a mutual fund corporation) received directly or through a trust (other than a mutual fund trust) or partnership,
- amounts included in the individual's income because of section 15 of the Act (other than such amounts that are in respect of listed shares), and
- trust or partnership income if the source of the income is the provision of goods or services by a trust or partnership to, or in support of, a business carried on
  - by a person who is related to the individual,
  - by a corporation of which a person who is related to the individual is a specified shareholder, or
  - by a professional corporation of which a person related to the individual is a shareholder.

### Tax on Split Income

ITA

120.4(2)

Subsection 120.4(2) of the Act imposes a new tax, at the rate of 29%, on an individual's split income for a taxation year.

To the extent that the tax on split income, together with any other regular tax payable, exceeds \$12,500, the 5% surtax imposed under section 180.1 of the Act will apply.

## **Tax Payable by a Specified Individual**

ITA  
120.4(3)

Subsection 120.4(3) of the Act provides that a specified individual's tax payable under Part I for a taxation year will not be less than 29% of the individual's split income for the year, reduced only by any dividend tax credit and foreign tax credit available in respect of amounts included in that split income.

New section 120.4 applies to the 2000 and subsequent taxation years.

## **Clause 25**

### **Overseas Employment Tax Credit**

ITA  
122.3

Section 122.3 of the Act provides a tax credit (the overseas employment tax credit) to individuals who are resident in Canada and employed outside Canada by a specified employer for at least six months in connection with resource, construction, installation, agricultural or engineering contracts or for purposes of obtaining those contracts.

ITA  
122.3(1)(e)(i)

Paragraph 122.3(1)(e) of the Act determines the amount of the overseas employment tax credit that is available to a taxpayer for a taxation year. Subparagraph 122.3(1)(e)(i) is amended to remove the reference to subsection 110.4(2) relating to the now lapsed forward averaging mechanism, which is being repealed.

This amendment applies to the 1998 and subsequent taxation years.

## ITA

## 122.3(2)

Subsection 122.3(2) of the Act defines the expression “tax otherwise payable under this Part for the year” against which an individual's overseas employment tax credit for a taxation year may be claimed. This subsection is amended to add a reference to new subsection 120.4(2) in order to exclude the tax on split income from that tax otherwise payable for the purpose of computing the overseas employment tax credit. The subsection is also amended to remove the reference to section 120.1 relating to the now lapsed forward averaging mechanism, which is being repealed.

These amendments apply to the 2000 and subsequent taxation years.

**Clause 26****Refundable Medical Expense Supplement**

## ITA

## 122.51(2)

Subsection 122.51(2) of the Act provides a refundable tax credit for eligible individuals – the refundable medical expense supplement. The supplement is equal to the lesser of \$500 and  $25/17^{\text{th}}$  of an eligible individual's medical expense tax credit, and is reduced by 5% of the individual's adjusted income in excess of a partially indexed threshold. The threshold (\$16,097 for 1998) is the total of the basic, spousal and disability amounts.

As a consequence of the increase of the basic and spousal amounts, the threshold is being increased to \$16,745 for 1999 and to \$17,419 (partially indexed) starting in 2000.

This amendment applies to the 1999 and subsequent taxation years.



## Clause 27

### Manufacturing and Processing Profits Deduction

ITA

125.1

Section 125.1 of the Act provides a reduced rate of corporate tax on Canadian manufacturing and processing profits. Generally, the rate reduction takes the form of the deduction, from Part I tax otherwise payable, of an amount equal to a specified percentage – currently 7% – of a corporation’s Canadian manufacturing and processing profits (other than profits eligible for the small business deduction under section 125 of the Act).

ITA

125.1(2) and (5)

The definition “Canadian manufacturing and processing profits” in subsection 125.1(3) of the Act provides, among other things, that such profits are to be determined under rules prescribed by regulation to be applicable to the “manufacturing or processing in Canada of goods for sale or lease”. However, paragraph (*h*) of the definition of “manufacturing or processing” in subsection 125.1(3) specifically excludes from its meaning the production or processing of electrical energy or steam, for sale.

Subsection 125.1(2) is added to extend the 7% corporate tax rate reduction to a corporation that generates electrical energy for sale, or produces steam for use in the generation of electrical energy for sale. New subsection 125.1(2) provides the formula (A-B) for computing the amount that is eligible for this corporate tax rate reduction, and which may be deducted in addition to any tax rate reduction available under the current rules in subsection 125.1(1).

For these purposes, the value of A in the formula is the amount to which the 7% rate reduction would be applied by a corporation if generating electrical energy for sale were not excluded from the meaning of “manufacturing or processing”. The description of A should be read in conjunction with new subsection 125.1(5).

For greater certainty, paragraph 125.1(5)(a) provides that electrical energy is deemed to be a good for the purpose of computing the value of A. Also, paragraph 125.1(5)(b) deems the generation of electrical energy for sale, or the production of steam for use in the generation of electrical energy for sale, to be manufacturing or processing, subject to the 10% gross revenue rule in paragraph (l) of the definition “manufacturing or processing”. Unless the 10% gross revenue rule is met by a corporation, the corporation’s activity is deemed to be excluded from the meaning of “manufacturing or processing”. Further, the small manufacturers’ rule in section 5201 of the *Income Tax Regulations*, which deems 100% of an eligible corporation’s “adjusted business income” to be “Canadian manufacturing and processing profits”, does not apply for the purpose of the description of A.

The value of B in the formula in subsection 125.1(2) is the amount to which the general 7% rate reduction may be applied by a corporation for the purpose of computing a Canadian manufacturing and processing profits tax rate reduction under the current rules.

The tax rate reduction available under these changes is phased in beginning January 1, 1999, with a one percentage point tax rate reduction for the calendar year 1999. The phase-in to a full seven percentage point tax rate reduction will be completed in 2002. The coming-into-force provision provides for a pro-ratio of the tax rate reductions for taxation years that straddle calendar years. A taxation year could begin in 2001 and end in 2003 because of the 53 week taxation year rule, and because of this paragraphs (e) and (f) of the coming-into-force rule both refer to the 7% rate applicable to the calendar years 2002 and 2003, respectively.

**Example:**Corporation X has:

Income from manufacturing or processing	=	\$500,000
Income from generating electricity	=	\$400,000
Other (inactive)	=	<u>\$100,000</u>
Total	=	\$1,000,000

Assume taxpayer claimed small business deduction on \$150,000.

M&P capital	= \$ 6 million	M&P Labour	= \$ 5 million
Total capital	= \$10 million	Total labour	= \$ 8 million

Assume: – \$2 million of total capital used directly to generate electricity for sale, and  
 – \$1 million of total labour used directly to generate electricity for sale.

*Calculation:***A. Where the generation of electrical energy for sale is an excluded M&P activity:**

$$\text{Canadian M\&P Profits} = \$900,000 @ 76\%^* = \$684,000$$

$$\begin{aligned} * \% \text{ determined as : } & \frac{\$7.05 \text{ million}^1 + \$6.67 \text{ million}^2}{\$10 \text{ million} + \$8 \text{ million}} \\ & = \$13.72/18 \text{ million} \\ & = 76\% \end{aligned}$$

*Note: Small manufacturers' rule does not apply as the corporation is engaged in an excluded activity.*

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<sup>1</sup> \$ 6 million @ 100/85

<sup>2</sup> \$ 5 million @ 100/75

*Application of subsection 125.1(1)**7% of the lesser of:*

- (a) \$684,000 less least of paragraph 125(1)(a) to (c). Assume least is the \$150,000 eligible for the small business deduction. That is to say,  $\$684,000 - \$150,000 = \underline{\$534,000}$ .
- (b) concerns taxable income etc. Assume = greater than \$534,000.

***B. Where the generation of electrical energy for sale is a preferred M&P activity:****Application of subsection 125.1(2)**7% of:**A - B = \$186,030 (\$720,030 [A] - \$534,000 [B]) where:**A = lesser of 125.1(1)(a) and (b) if electrical generating qualifies**125.1(1)(a)**Canadian M&P profits = \$870,030 (\$900,000 @ 96.67%\*)**Less = \$150,000 (least of 125(1)(a) to (c))  
\$720,030*

$$\begin{aligned}
 * \% \text{ determined as: } & \frac{\$ 9.4 \text{ million}^3 + \$ 8 \text{ million}^4}{\$ 10 \text{ million} + \$ 8 \text{ million}} \\
 & = \$ 17.4/18 \text{ million} \\
 & = 96.67\%
 \end{aligned}$$

*125.1(1)(b) concerns taxable income etc.**Assume = greater than \$720,030.**B = where generating electricity is an excluded activity  
= \$534,000 (see above).*

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<sup>3</sup> \$ 8 million @ 100/85<sup>4</sup> \$ 6 million @ 100/75

## Clause 28

### Foreign Tax Deduction

ITA

126

Section 126 of the Act provides rules under which taxpayers may deduct, from tax otherwise payable under Part I, amounts they have paid in respect of foreign taxes.

ITA

126(1), (2.1) and (3)

As a consequence of the lapsing at the end of 1997 of the forward averaging mechanism, the references in this section to subsection 110.4(2) of the Act are removed. Those references are currently in subclauses 126(1)(b)(ii)(A)(I) and (2.1)(a)(ii)(A)(I), and in subparagraph 126(3)(b)(i). A reference to paragraph 20(1)(ww) is being added to each of those provisions to ensure that the income base used for determining foreign tax credits is not reduced by the new paragraph 20(1)(ww) deduction which relates to the new tax on split income.

See the commentary on new paragraph 20(1)(ww) and new section 120.4 implementing the tax on split income.

ITA

126(7)

The description of the expression “tax for the year otherwise payable under this part” in subsection 126(7) of the Act is amended to eliminate the reference to section 120.1, which is being repealed as a consequence of the lapsing at the end of 1997 of the forward averaging mechanism.

These amendments apply to the 1998 and subsequent taxation years except that, in their application to the 1998 and 1999 taxation years, subclauses 126(1)(b)(ii)(A)(I) and (2.1)(a)(ii)(A)(I) and subparagraph 126(3)(b)(i) are to be read without reference to the expression “computed without reference to paragraph 20(1)(ww)”.



**Clause 29****Labour-Sponsored Venture Capital Corporations**

ITA

127.4

Section 127.4 of the Act provides a tax credit to individuals in respect of the acquisition of “approved shares” issued by prescribed labour-sponsored venture capital corporations. The tax credit is up to \$750 per taxation year for acquisitions in the year and in the first sixty days of the following taxation year.

**Definitions**

ITA

127.4(1)

“approved share”

Subsection 127.4(2) of the Act allows an individual a tax credit for the acquisition of an “approved share”, which is defined in subsection 127.4(1) as a share issued by a prescribed labour-sponsored venture capital corporation (LSVCC). LSVCCs prescribed for this purpose under section 6701 of the Regulations include LSVCCs registered under Part X.3 of the Act, as well as specified provincially registered LSVCCs.

Paragraph (a) of the definition “approved share” in subsection 127.4(1) is added, in conjunction with the introduction of subsection 204.8(2), to exclude from the definition a share of a federally registered LSVCC the venture capital business of which was discontinued before the time of the issue of the share. For more details on when an LSVCC discontinues its venture capital business, see the commentary on new subsection 204.8(2).

New paragraph (b) of the same definition excludes from the definition certain shares issued by a provincially registered LSVCC that is not also a federally registered LSVCC. This exclusion applies only in the unusual event that, at the time of the issue of the shares, no assistance in respect of the acquisition of such shares is, because of a suspension or termination of assistance to the LSVCC under the

laws of each province in which the LSVCC is registered, being provided.

These amendments apply to the 1999 and subsequent taxation years.

“tax otherwise payable”

The LSVCC tax credit is deducted against “tax otherwise payable”, which is tax under Part I of the Act (determined without regard to a number of referenced provisions).

The definition “tax otherwise payable” in subsection 127.4(1) is amended to remove the reference to section 120.1, which is being repealed as a consequence of the lapsing of the forward averaging mechanism at the end of 1997.

This amendment applies to the 1998 and subsequent taxation years.

## **Amalgamations or Mergers**

ITA

127.4(1.1)

Subsection 127.4(1.1) of the Act is introduced so that the continuation rules set out in new subsection 204.85(3) for amalgamations and mergers also apply for the purposes of section 127.4. Thus, for example, where a federally registered LSVCC amalgamates with another corporation and paragraph 204.85(3)(d) applies to the new corporation, the acquisition by an individual of a Class A share issued by the new corporation will generally allow the individual to claim an LSVCC tax credit in accordance with the rules in section 127.4. For information on new subsection 204.85(3), see the commentary on that subsection.

New subsection 127.4(1.1), in conjunction with new paragraph (a) of the definition “approved share” in subsection 127.4(1), also ensures that new subsection 204.8(2) applies for the purpose of section 127.4. Subsection 204.8(2) sets out the circumstances in which an LSVCC discontinues its venture capital business. These amendments ensure that the acquisition by an individual of the share of a federally registered LSVCC that discontinued its venture capital business before the time the share was issued does not give rise to a tax credit

under section 127.4. For more details on new subsection 204.8(2), see the commentary on that subsection.

New subsection 127.4(1.1) applies after February 16, 1999.

## **Clause 30**

### **Minimum Tax**

ITA

127.5

Section 127.5 of the Act levies the minimum tax payable by an individual under Part I for a taxation year.

This section is amended to delete the references to section 120.1, related to the now lapsed forward averaging mechanism. Section 127.5 is also amended to provide that the minimum tax in respect of a taxpayer for a taxation year will not be less than the new tax on split income under section 120.4 in respect of the taxpayer for the year.

For information on the tax on split income, see the commentary on new section 120.4.

These amendments generally apply to the 1998 and subsequent taxation years.

## **Clause 31**

### **Communal Organizations**

ITA

143

Section 143 of the Act sets out rules governing the taxation of communal organizations (referred to in that section as “congregations”) that do not allow their members to own property in their own right. A number of amendments to these rules are being introduced. Except as noted otherwise, these amendments apply to the 1998 and subsequent taxation years.

## Subclause 31(1)

### ITA 143(1)

Subsection 143(1) of the Act provides that, where a religious congregation that does not allow its members to own property in their own right, or one or more of its business agencies over which it has effective management or control, carry on a business, an *inter vivos* trust is deemed to exist. Property of the congregation or its agencies is treated as property of the trust. The congregation and its business agencies are deemed to act as agents for the trust in all matters relating to their business activities. Income earned by the congregation or such business agencies is included in computing income at the trust level, with provision for allocation of that income under subsection 143(2) to adult members of the congregation.

Subsection 143(1) is amended so that the application of these rules to “business agencies” is limited to “business agencies” that are newly defined in subsection 143(4). Under the new definition, a corporation, trust or other entity is treated as a business agency of a congregation in a calendar year only where, throughout the portion of the year during which the entity exists, the congregation owns all shares of the capital stock of the corporation (with the exception of any directors' qualifying shares) or all interests in the other entity, as the case may be. This change is intended to accommodate third party minority interests in businesses over which a congregation has effective management and control, with the entire income from the business to be taxed in accordance with regular income tax rules rather than being allocated to the congregation. While this amendment applies to the 1998 and subsequent taxation years, as a transitional measure the effective management or control test will continue to apply to corporations, trusts and other entities in connection with taxation years that began before March 1999.

New subparagraph 143(1)(l) provides that, in applying section 20.01 (private health services plans) to a trust that is deemed to be created under subsection 143(1), the trust may deduct in computing its income an amount payable under a private health services plan for the benefit of the members of the congregation. In applying section 20.01 to such a trust, the limitations on deductibility found in paragraphs 20.01(2)(b) and (c) and subsection 20.01(3) do not apply

in computing its income. The introduction of paragraph 143(1)(l) is strictly consequential to the introduction of section 20.01 as part of the amendments implementing the private health services plans measures announced in the 1998 budget.

Additional amendments of an organizational or clarifying nature are being made to subsection 143(1). These amendments are summarized in the table below.

Existing Law	New Reference	Summary
143(1)(a) to (c)	143(4)	Existing description of congregations to which section 143 applies is now contained in an amended definition of "congregation" in subsection 143(4).
143(1) mid text	143(1) --portion before (c)	Clarifies time at which trust is considered to exist.
143(1)(d)	143(1)(c) and (d)	Provides that property of a congregation and a business agency is deemed to be property of the trust. In the latter case, new paragraph 143(1)(d) ensures that this rule applies only to property of an entity that is a "business agency". See the new definition of "business agency", described in the commentary above.



143(1)(g)	143(1)(g) and (h)	Provides that a congregation and its business agencies are deemed to act as agents for the deemed trust. In the latter case, new paragraph 143(1)(h) ensures that the rule applies only in a calendar year in connection with an entity that is a business agency in that year. See also the new definition “business agency”, described in the commentary above.
143(1)(h) and (i)	143(1)(i) and (j)	Renumbering changes only.
143(1)(j)	143(1)(k)	The current rule ensures that no deduction in computing income is available in respect of salaries, wages or benefits paid to congregation members. The new rule also makes it clear that no deduction is available to the trust under subsection 104(6), except as allowed by subsection 143(2). The new rule is also subject to new paragraph 143(1)(l), described in the commentary above.
143(1)(k)	143(1)(m)	Renumbering change only.

## ITA

## 143(2) and (5)

Subsection 143(2) of the Act provides an election under which taxable income earned by the deemed trust as a consequence of the rules in subsection 143(1) is allocated to members of the congregation. Under the existing election, 80% of the congregation's taxable income is divided by the number of adult members of the congregation. In the case of an unmarried adult, this quotient is the adult's mandatory share of the congregation's taxable income. In each

case where there are two married adults in a family, twice the amount of the quotient is allocated to the adult spouse designated by the congregation. The remaining 20% of the congregation's taxable income must be allocated among unmarried adults and designated spouses. The congregation has the discretion to divide this remainder in unequal shares.

Subsection 143(2) is amended to clarify that the taxable income allocated among congregation members is taxable income determined without reference to subsection 104(6) (deduction for deemed income distributions to members) and "specified future tax consequences" as defined in subsection 248(1) (e.g., loss carrybacks from a future taxation year). For the purposes of the commentary below on amendments to section 143, the references to taxable income mean taxable income so determined.

Subsection 143(2) is also amended to allow for a wider allocation of taxable income among adult members of a congregation (or, more specifically, among "participating members" of the congregation, as described below), in order to better reflect their relative contributions to the businesses carried on by the congregation. Under the new election, 80% of a congregation's taxable income is divided by the total of the number of unmarried adults in the congregation and 150% of the number of married couples in the congregation. This quotient is the mandatory share of the congregation's taxable income for each unmarried adult and for one spouse in each of the married couples. One-half of the quotient is the mandatory share of the congregation's taxable income for each of the other spouses. The remaining 20% of the congregation's taxable income must now be allocated among all adults, with the congregation's discretion to divide this remainder in unequal shares extended accordingly. (In the event that the remaining 20% of taxable income is not fully allocated by the congregation in the election, the residual amount is allocated equally to participating members.) The example below illustrates the operation of amended subsection 143(2).

### **EXAMPLE**

*The participating members of a Hutterite colony consist of 20 married couples and 10 single adults. The colony earns \$900,000 of income. At present, 80% of its taxable income is divided into 50 shares. Two of these shares are allocated to one spouse of*

*each of the married couples; one share is allocated to each single adult. Consequently, each share of taxable income is equal to \$14,400 (i.e.,  $80\% \times \$900,000/50$ ). The remaining 20% of taxable income is allocated among the single adults (10) and designated spouses (20).*

*Under the proposed amendment, 80% of the colony's taxable income would be divided into 40 shares (i.e.,  $10 + (150\% \times 20)$ ). Each single adult and designated spouse would be allocated a full share of \$18,000 (i.e.,  $80\% \times \$900,000/40$ ). Each other spouse would be allocated \$9,000. The remaining 20% of taxable income would be allocated among the 50 adults in the colony.*

Amended subsection 143(2) provides for the allocation of a congregation's taxable income under an election for a taxation year only to "participating members" of the congregation. For drafting convenience, this expression is newly defined in amended subsection 143(4) as a "member of the congregation" who is an "adult" at the end of the year. The latter two expressions are already defined in subsection 143(4).

Amended subsection 143(2) also provides, in conjunction with amended subsection 143(5), that designations of mandatory full and half shares of taxable income among spouses in a particular family must be made consistently to the same spouses. The spouse in a family to whom taxable income was allocated under the existing rules is the spouse to whom the full share under the new regime is required to be allocated.

Subsection 143(2) is also amended to ensure that the taxable income of congregation members is determined without reference to subsection 110(2), which provides for the deduction of the value of certain gifts made to religious orders. This amendment replaces a similar rule that is currently provided in paragraph 143(3)(c).

It should be noted that amended subsection 143(2) does not contain any express prohibition with regard to the deduction of expenses incurred for the support, maintenance and satisfaction or personal needs of congregation members. The express prohibition in paragraph 143(2)(a) in this regard is not necessary and is being eliminated, as there is no basis to claim the deduction of such expenses.

ITA  
143(3)

Subsection 143(3) of the Act provides that an election under subsection 143(2) (see above) is not binding on the Minister of National Revenue for a taxation year unless:

- the election is made by the deadline for filing the trust tax return;
- there are no unpaid income taxes, interest and penalties for the congregation's members in connection with elections made for preceding taxation years; and
- no amounts are deducted by members of the congregation under subsection 110(2) in connection with gifts by members of a religious order to the order.

Subsection 143(3) is amended so that it no longer deals with election deadlines or deductions under subsection 110(2). It is intended that late elections be dealt with under the fairness rules in subsections 220(3.2) to (3.7) of the Act by prescribing the election under subsection 143(2) in section 600 of the Regulations.

A prohibition for a deduction under subsection 110(2) is provided in amended subsection 143(2).

**Subclause 31(2)**

**Election in Respect of Gifts**

ITA  
143(3.1)

Subsection 143(3.1) of the Act allows a communal organization which makes an election under subsection 143(2) (see commentary on subsection 143(2)) to elect to have its charitable, Crown and cultural gifts made in a year treated as having been made by its members for whom an amount is included in income for the year under subsection 143(2).

Subsection 143(3.1) is amended to provide that total ecological gifts made by a deemed trust are also treated as having been made by its



participating members where an election under the subsection is made by the trust. This amendment applies to the 1995 and subsequent taxation years.

Subsection 143(3.1) is also amended to provide technical clarity and consistency with the rest of section 143.

### **Subclauses 31(3) and (4)**

#### **Definitions**

ITA

143(4)

“congregation”

A “congregation” is defined in subsection 143(4) of the Act as a community, society or body of individuals that adheres to the practices and beliefs of, and operates according to the principles of, the religious organization of which it is a constituent part. Under existing subsection 143(1), the rules in section 143 apply only to congregations that satisfy the conditions set out in paragraphs 143(1)(a) to (c), including the condition that members not own any property in their own right.

This definition is amended so that these conditions are, for convenience, incorporated in the definition.

“business agency”

“participating member”

Subsection 143(4) of the Act is also amended to introduce the definitions “business agency” and “participating member”. These definitions are discussed in the commentary above on amended subsections 143(1) and (2).

“total ecological gifts”

The definition “total ecological gifts” is introduced as a consequence of changes made to the election under subsection 143(3.1) in respect of gifts available to a trust. This definition, which has the same meaning as that for the same expression in subsection 118.1(1),



relating to the tax credit available in respect of such gifts, applies to gifts made after February 27, 1995.

### **Subclause 31(5)**

#### **Specification of Family Members**

ITA

143(5)

Subsection 143(5) of the Act provides that allocations made by a congregation of taxable income to a married couple during their marriage must be made consistently to the same spouse. As set out in the commentary on amended subsection 143(2), this subsection is amended so that it similarly applies, in connection with the new rules in subsection 143(2), for allocating taxable income among congregation members.

### **Clause 32**

#### **Registered Retirement Savings Plans**

ITA

146

Section 146 of the Act provides rules governing the treatment of registered retirement savings plans (RRSPs)

#### **Definitions**

ITA

146(1)

“refund of premiums”

The definition “refund of premiums” in subsection 146(1) of the Act is relevant for the purposes of determining the income inclusion for a deceased RRSP annuitant on death, the amount from a deceased annuitant’s RRSP that an RRSP beneficiary may include in income and the amount that can be transferred by a beneficiary on a tax-deferred basis under paragraph 60(l). Because of the definition

“designated benefit” in subsection 146.3(1), the definition “refund of premiums” is also relevant in connection with similar rules that apply on the death of the annuitant under a registered retirement income fund (RRIF).

Where an amount is received out of an RRSP of a deceased annuitant as a “refund of premiums”, subsection 146(8.9) applies. In general, the amount so received offsets the income inclusion otherwise determined under subsection 146(8.8) for the annuitant in respect of the value of the RRSP on the annuitant's death. Under paragraph (a) of the definition, an amount paid to the deceased annuitant's spouse qualifies as a refund of premiums where the annuitant died before the date fixed for retirement income to be paid from the plan. Under paragraph (b) of the definition, the same treatment applies to amounts paid to a financially dependent child or grandchild of the deceased, but is restricted to cases where there is no surviving spouse. There is a rebuttable presumption under the definition that a child or grandchild is not financially dependent if, for the year preceding that of the annuitant's death, the income of the child or grandchild exceeded the total of the \$500 supplementary amount and the basic personal amount. (For deaths that occurred in 1998, this total produces an income threshold of \$6,956.)

Paragraph (b) of the definition is amended so that it is no longer restricted to cases where there is no surviving spouse. As a consequence, refunds of premiums may be received (or deemed by subsection 146(8.1) to be received) by a financially dependent child or grandchild even where there is a surviving spouse, and included in computing the dependant's income. If the dependant is mentally or physically infirm or under 18 years of age, paragraph 60(l) provides a number of mechanisms to permit the deferral of the income inclusion. The amendment results in similar consequences for the rules that apply where a RRIF annuitant dies.

The amendment to paragraph (b) of the definition applies to deaths that occur after 1998.

This amendment also applies to deaths that occurred after 1995 and before 1999, but only where a written election to this effect is filed with the Minister of National Revenue (MNR) before May 2000 (or before a later day acceptable to the MNR). The election must be filed jointly by the affected dependant and the legal representative of

the deceased annuitant. Where the election is filed, the deadline for each of the 1996 to 1998 taxation years for transfers to be made to take advantage of the deferral mechanisms under paragraph 60(I) for affected dependants is extended from the 60<sup>th</sup> day following the year to February 29, 2000 (or a later day acceptable to the MNR). The dependant's election to take advantage of the deferral mechanism in these circumstances must be filed with the MNR before May 2000 (or a later day acceptable to the MNR).

As a consequence of the increase from \$6,456 to \$7,131 of the basic personal amount and the two-year phase-out of the \$500 supplementary amount, the threshold for determining financial dependency under the "refund of premiums" definition is increased to \$7,044 if the annuitant's death occurs in 1999 and to \$7,131 (partially indexed) if the annuitant's death occurs after 1999. This amendment applies to the 2000 and subsequent taxation years. (For information on the changes to the personal amounts, see the commentary on subsection 118(1) of the Act.)

### **Deemed Receipt of Refund of Premiums**

ITA

146(8.1)

Subsection 146(8.1) of the Act deals with the case where the estate of a deceased RRSP annuitant receives an amount out of the deceased's RRSP and beneficiaries of the estate (i.e., a surviving spouse or financially dependent child or grandchild) are eligible to receive a refund of premiums. In these circumstances, an eligible beneficiary and the legal representative of the deceased may file a joint election with the Minister of National Revenue to treat the RRSP amount received by the estate as a refund of premiums received by the beneficiary.

Subsection 146(8.1) is amended to clarify that the refund of premiums is deemed to be received by the beneficiary (and not by the legal representative) in these circumstances at the same time as the corresponding RRSP amount was paid to the legal representative. This is consistent with a similar rule for RRIFs in subsection 146.3(6.1).

This amendment applies to the 1999 and subsequent taxation years.

## Clause 33

### Joint Liability

ITA

160

Section 160 of the Act imposes joint and several liability on taxpayers for income taxes owing in certain circumstances.

Where a child is liable to pay the tax on split income under new section 120.4 of the Act, new subsection 160(1.2) of the Act imposes a joint and severable liability for the tax on a parent of the child if the parent

- carried on a business that purchased goods or services from another business any income from which is split income of the child,
- was a specified shareholder of a corporation that purchased goods or services from a business any income from which is split income of the child,
- was a specified shareholder of a corporation dividends of which were directly or indirectly included in computing the child's split income for the year,
- was a shareholder in a professional corporation that purchased goods or services from a business any income from which is split income of the child, or
- was a shareholder in a professional corporation dividends of which were directly or indirectly included in computing the child's split income for the year.

For information on the tax on split income, see the commentary on new section 120.4.

This amendment applies to the 2000 and subsequent taxation years.

**Clause 34****Interest**

ITA

161(12)

Subsection 161(12) of the Act allows interest on a penalty referred to in the tax shelter identification rules in subsection 237.1(7.4) to be assessed against a partnership and applies the provisions of the Act relating to assessments, objections and appeals with respect to interest as if the partnership were a corporation. Subsection 161(12) is repealed as a consequence of being consolidated with a similar rule in subsection 163(2.9) of the Act.

**Clause 35****Offset of Refund Interest and Arrears Interest**

ITA

161.1

New section 161.1 of the Act sets out a rule that allows a corporation to offset income tax refund amounts on which refund interest is accruing in the corporation's favour against concurrent income tax arrears amounts in respect of which arrears interest is accruing against the corporation. The rule effectively enables a corporation to avoid paying non-deductible arrears interest for a period for which refund interest is being calculated in the corporation's favour in respect of an equal but opposite underlying balance. By offsetting the underlying tax and refund amounts owed, both types of interest are eliminated for the period for which the interest-carrying balances overlap. Since refund interest is taxable, while arrears interest is both non-deductible and calculated at a higher rate than refund interest, the corporation is better off by having eliminated the two interest amounts.



## Definitions

### ITA

#### 161.1(1)

Subsection 161.1(1) of the Act sets out definitions of terms used in the interest offset rules in new section 161.1.

“accumulated overpayment amount” and “accumulated underpayment amount”

A corporation's “accumulated overpayment amount” and “accumulated underpayment amount” for a period are defined to be the principal amount of the overpayment or overpayment, as the case may be, for that period together with refund or arrears interest (including compound interest), as the case may be, that accrued on the principal amount prior to the date specified by the taxpayer for the offset.

“arrears interest”

“Arrears interest” is defined to mean interest owing by a taxpayer to the Crown, which interest is calculated under any one of a list of provisions in the Act that levy interest in respect of tax and penalties payable by a taxpayer and excess refunds and interest amounts incorrectly paid to a taxpayer.

“overpayment amount”

A corporation's “overpayment amount” for a period is an amount that has been refunded to the corporation on which refund interest is calculated for the period, or an amount to which the corporation is entitled that has not yet been refunded but in respect of which refund interest for the period would be paid if it were refunded. An overpayment amount relates to a single taxation year.

“refund interest”

“Refund interest” is defined to mean interest payable by the Crown to a taxpayer, which interest is calculated under any one of a list of provisions in the Act that require interest to be paid in respect of certain amounts refunded or repaid to a taxpayer.

“underpayment amount”

A corporation's “underpayment amount” for a period is an amount payable by the corporation, such as tax, a penalty, an excessive refund, or an excessive amount of refund interest paid, on which arrears interest is calculated for the period. A refund amount is not considered to be an underpayment amount for the time prior to the date at which refund interest commences. An underpayment amount relates to a single taxation year.

**Concurrent Refund Interest and Arrears Interest**

ITA

161.1(2)

New subsection 161.1(2) of the Act sets out the conditions under which a corporation may apply for an interest offset. Offsetting is available where there is a period throughout which both refund interest is calculated on an overpayment amount owing to the corporation and arrears interest is calculated on an underpayment amount owed by the corporation. While the overpayment and underpayment amounts may consist of one or more of tax, penalty and interest, all such amounts must relate to tax levied under one or more of Parts I, I.3, II, IV, IV.1, VI, VI.1 and XIV of the Act.

Reallocation is available only in respect of periods that are after 1999 for which concurrent refund interest and arrears interest are calculated. Interest for such periods may relate to overpayment and underpayment amounts in respect of taxation years that are before 2000. In such cases, though, offsetting is only available in respect of interest amounts that accrue after 1999.

Where these conditions are met, the corporation may apply in writing to the Minister of National Revenue to have the accumulated overpayment amount (which includes accrued interest) reallocated on account of the accumulated underpayment amount (which also includes accrued interest).

It should be noted that reallocation is available in respect of concurrent overpayment and underpayment amounts even if one or both of the amounts has been settled by payment after the end of the overlap period.

## Contents of Application

ITA

161.1(3)

New subsection 161.1(3) of the Act sets out the requirements for a valid application for an interest offset. Paragraph (a) requires that the application specify the amount to be reallocated. While the corporation may choose the amount to be reallocated, and thus choose less than full offsetting, the amount to be reallocated may not exceed the lesser of the accumulated overpayment for the overlap period identified and the accumulated underpayment for that period. If there are, for example, overpayments for a period in respect of more than one taxation year, each one is a separate overpayment and is offset separately, though potentially against the same underpayment.

Paragraph 161.1(3)(b) requires that the application specify the effective date for the reallocation. This date, which must be after 1999, may not be earlier than the earlier of the date from which refund interest is calculated on the overpayment amount and the date from which arrears interest is calculated on the underpayment amount. This ensures that offsetting is available only in respect of concurrent periods for which refund and arrears interest are calculated.

Paragraph 161.1(3)(c) describes the time limit within which the application for offset is required to be made.

## Reallocation

ITA

161.1(4)

New subsection 161.1(4) of the Act sets out the effect of an application for an interest offset. Where a valid application is made, the specified portion of the accumulated overpayment amount is deemed to have been refunded to the corporation and paid on account of the accumulated underpayment amount on the date specified in the application. The accumulated underpayment amount is thus reduced by the amount reallocated. As a result, no refund interest accrues after the effective date with respect to the portion of the overpayment amount reallocated, and no arrears interest accrues after that date with

respect to the portion of the accumulated underpayment amount offset by the reallocation. Thus, all interest on the offsetting balances is eliminated for the offset period.

### **Repayment of Refund**

ITA

161.1(5)

New subsection 161.1(5) of the Act applies where any portion of an accumulated overpayment amount sought to be reallocated by a corporation has already been refunded to the corporation prior to the effective date of the reallocation. In that case, the portion of the amount reallocated that was previously refunded, and any refund interest applicable to those refunds, are deemed to have become payable by the corporation on the day on which the portion was refunded. Thus, the corporation is required to repay any refunded amount that it later applies to have reallocated.

Paragraph 161.1(5)(b) levies interest at the arrears rate on the reversed refund from the date it was originally paid to the corporation.

### **Consequential Reallocations**

ITA

161.1(6)

New subsection 161.1(6) of the Act applies where any portion of a corporation's accumulated underpayment amount, against which the corporation has sought to reallocate an overpayment amount, has already been paid by the corporation prior to the effective date of the reallocation. In this circumstance, once the reallocation is processed, the corporation's payment will have been excessive and will create a new entitlement to a refund. If refund interest is applicable to this new amount, it is considered to be an overpayment amount. The corporation is entitled to have this consequential overpayment amount reallocated under the interest offset provision only if the corporation requests its reallocation in the application for the original reallocation. This prevents a reallocation request from becoming the first in a series of consecutive consequential reallocations.



## **Assessments**

ITA

161.1(7)

New subsection 161.1(7) of the Act is a facilitative rule requiring the Minister of National Revenue to reassess interest and penalties payable by a corporation in order to take into account a reallocation under the interest offset provisions. Since the time limit for requesting a reallocation under new paragraph 161.1(3)(c) of the Act is the latest of a number of dates involving the assessment of the taxation year to which an underpayment or overpayment amount relates, it is possible that one of the taxation years will have become statute-barred under the normal rules by the time the reallocation is requested. This provision specifies that the Minister shall assess or reassess interest and penalties as necessary in order to take into account a reallocation notwithstanding the expiry of the normal reassessment periods set out in subsection 152(4), (4.01) and (5) of the Act.

An amendment to paragraph 165(1.1)(a) of the Act limits the right of the corporation to object to such consequential reassessments. A full description of that amendment is provided in the notes to that provision.

New section 161.1 of the Act applies after 1999.

## **Clause 36**

### **Where Partnership Liable to Penalty**

ITA

163

Section 163 of the Act imposes penalties in respect of serious failures to comply with the Act, such as making false statements or omitting to report income.



ITA  
163(2.9)

Subsection 163(2.9) of the Act allows a penalty imposed under subsection 163(2.4) to be assessed against a partnership and applies the provisions of the Act relating to assessments, interest, refunds, objections and appeals with respect to the penalty as if the partnership were a corporation. Subsection 163(2.9) is amended in two respects. First, it is revised to apply to a penalty assessed against a partnership under the tax shelter identification rules in subsection 237.1(7.4) of the Act. The second amendment adds a reference to section 163.2 of the Act, which provides the new third party civil penalty rules. These amendments come into force on Royal Assent.

ITA  
163(3)

Subsection 163(3) of the Act provides that the onus of establishing the facts justifying the assessment of a civil penalty under section 163 is, in any appeal under the Act, on the Minister of National Revenue. Subsection 163(3) is amended to also apply to an assessment of a third party civil penalty under new section 163.2 of the Act.

## **Clause 37**

### **Misrepresentation of a Tax Matter by a Third Party**

ITA  
163.2

New section 163.2 of the Act sets out the rules that apply for the purpose of applying civil penalties to third parties that make false statements or omissions in relation to tax matters.

Background information is provided below. The application of the detailed rules is more fully described in commentary following this background information. Detailed examples are provided at the end of the commentary on section 163.2.

## *Background*

Canadian tax law includes both criminal and civil penalties that may apply to misrepresentations of tax matters to ensure that all taxpayers pay their fair share of taxes. Criminal penalties may apply where a person participates in tax evasion in respect of their or another person's taxes. Civil penalties may apply where taxpayers are shown to have knowingly, or in circumstances amounting to gross negligence, made false statements or omissions in the filing of the taxpayer's own tax information. However, Canadian tax law has not provided clear rules for assessing civil penalties for making or counselling false statements in respect of another person's tax liability. In April of 1998, the Technical Committee on Business Taxation (the "Mintz Committee") recommended that the tax law be revised to provide civil penalties against those who knowingly, or in circumstances amounting to gross negligence, make false statements or omissions in respect of another person's tax matters.

The 1999 budget proposed to apply civil penalties to third parties who make false statements that could be used for tax purposes. In particular, two penalties were proposed, with general commentary and two examples being included in Annex 7 of the 1999 Budget Plan, which was released on February 16, 1999.

During the post-budget consultation period, concerns were expressed by professional bodies on behalf of their membership that the proposed civil penalty provisions could apply in cases where a tax professional makes an honest error of judgement, or where there is an honest difference of opinion. These concerns reflected a concern about the proposed gross negligence standard rather than the other test for liability that is based on a knowledge standard.

The gross negligence standard has been used elsewhere in the tax law and has been judicially interpreted in a number of cases. In the government's view there is a great deal of difference between "ordinary" negligence and "gross" negligence. It is not the government's policy intent to apply a third party penalty under new section 163.2 in cases of conduct that is an honest error of judgement, or an honest difference of opinion. Rather the gross negligence standard was selected because it addresses this legitimate concern while ensuring that participants in otherwise culpable activity do not escape liability.

Nevertheless, in response to representations of professional bodies, section 163.2 substitutes for “gross negligence” the concept “culpable conduct” which is defined with reference to the types of conduct to which the courts have, in the past, applied a civil penalty under the tax law. In addition, section 163.2 includes an exception for reliance in good faith that confirms that a person who is preparing or filing a tax return on behalf of a taxpayer is not considered to have acted in circumstances amounting to culpable conduct by reason only of having relied, in good faith, on information provided by the taxpayer.

New section 163.2 comes into force on Royal Assent.

## ITA

### 163.2(1)

New subsection 163.2(1) provides definitions that apply for the purpose of new section 163.2. The terms defined for this purpose are “culpable conduct”, “entity”, “false statement”, “gross entitlements”, “participates”, “person”, “planning activity”, “subordinate”, and “valuation activity”. Below is more detailed commentary on some of these definitions.

“Culpable conduct” means conduct, whether an act or a failure to act, that

- (a) is tantamount to intentional conduct,
- (b) shows an indifference as to whether the Act is complied with, or
- (c) shows a wilful, a reckless or a wanton disregard of the law.

“False statement” includes a statement that is misleading because of an omission from the statement. The meaning of a “false statement” is also modified in certain cases to deem two or more false statements to be one false statement (see the commentary on new subsection 163.2(7) of the Act).

“Gross entitlements” of a person at any time, in respect of a planning activity or a valuation activity of the person, means all amounts to which the person (or another person not dealing at arm’s length with

the person) is entitled, either before or after that time and either absolutely or contingently, to receive or obtain. The definition “gross entitlements” is relevant for the purpose of computing a penalty under new subsection 163.2(2) for making or furnishing a false statement in respect of tax planning arrangements. Reference should also be made to new paragraph 163.2(10)(b), which provides special rules that may apply in particular circumstances to exclude certain amounts from a person’s gross entitlements in respect of a planning activity or a valuation activity.

Generally, “planning activity” includes organizing or creating an entity, plan, scheme or arrangement. It also includes participating (directly or indirectly) in the selling of an interest in, or the promotion of, an entity, plan, scheme or arrangement.

“Valuation activity” of a person means anything done by the person in determining the value of a property or a service.

## ITA

### 163.2(2) and (3)

New subsection 163.2(2) provides for a penalty where a person makes or furnishes, or causes another person to make or furnish, a statement that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct, is a false statement that could be used by another person for a purpose of the Act. The amount of the penalty is determined under new subsection 163.2(3).

Subsection 163.2(3) provides that the penalty to which a person is liable under subsection 163.2(2) in respect of a false statement is one of two amounts. The first amount applies where a false statement is made in the course of a planning activity or a valuation activity, and is the greater of \$1,000 and the total of the person’s gross entitlements in respect of the planning activity and the valuation activity calculated at the time at which notice of assessment of the penalty is sent to the person. In certain cases, the computation of a person’s gross entitlements may be in respect of two or more false statements deemed to be one false statement (see the commentary on new subsection 163.2(7) of the Act).

The second amount is \$1,000, which applies in any other case.



## ITA

## 163.2(4) and (5)

New subsection 163.2(4) provides for a penalty where a person makes (or participates in, assents to or acquiesces in the making of) a statement to, or by or on behalf of, another person that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct, is a false statement that could be used by or on behalf of the other person for a purpose of the Act. The amount of the penalty is determined under new subsection 163.2(5).

New subsection 163.2(5) provides that the penalty to which a person is liable under subsection 163.2(4) in respect of a false statement is the greater of two amounts. The first amount is \$1,000. The second amount is the penalty to which the other person would be liable under the gross negligence penalty provision in subsection 163(2) of the Act if the other person made the statement in a return filed for the purposes of the Act and knew the statement was false. Generally, this is the amount of tax sought to be avoided, or the amount of an excess refund sought to be obtained.

## ITA

## 163.2(6)

New subsection 163.2(6) provides an exception for reliance in good faith, which applies for the purpose of applying the penalty provision in subsection 163.2(2) (other than in respect of a statement made in the course of a planning activity or a valuation activity) and for the purpose of applying the penalty provision in subsection 163.2(4). This exception provides that a person is not considered to have acted in circumstances amounting to culpable conduct by reason only of having relied, in good faith, on information provided to the person by the other person (see subsections 163.2(2) and (4)) or, because of such reliance, failed to verify, investigate or correct the information.

## ITA

## 163.2(7)

New subsection 163.2(7) provides two rules. First, if applicable, paragraph 163.2(7)(a) treats two or more false statements made or furnished by a person in the course of one or more planning activities



(or a valuation activity) as one false statement for the purpose of applying the penalty in subsection 163.2(2) in respect of the person's false statements. This is the case where a person's false statements were made or furnished in the course of one or more planning activities that are in respect of a particular entity, plan, scheme, or arrangement or in the course of a valuation activity that is in respect of a particular property or service.

Second, a person is not considered to have participated in a planning activity or a valuation activity solely because the person provided clerical or secretarial services with respect to the activity.

## ITA

### 163.2(8) and (9)

New subsection 163.2(8) provides a special rule that applies to a false statement, as to the value of a property or service, made by a person who opines on the value of the property or service, or by a person engaged in a planning activity that is the selling of an interest in (or the promotion of) an entity, plan, scheme or arrangement. A statement as to the value of a property or service is considered to be a statement that the person would reasonably be expected to know, but for circumstances amounting to culpable conduct, is a false statement if the stated value is

- less than the prescribed percentage for the property or service multiplied by the fair market value of the property or service, or
- greater than the prescribed percentage for the property or service multiplied by the fair market value of the property or service.

These two parameters provide a range in value outside of which this “reverse onus” rule will apply.

This reverse onus rule applies only where Revenue Canada establishes that the stated value of a property or service is outside of the range. Further, new subsection 163.2(9) provides that subsection 163.2(8) does not apply to a person in respect of a statement as to a value if the person establishes that the stated value was reasonable in the circumstances and that the statement was provided in good faith.

The Regulations will be amended to set the prescribed percentages for the purposes of subsection 163.2(8) after the conclusion of consultations on the appropriate percentages.

In summary, where a person's statement as to the value of a property or service is within the range, the liability for a penalty under subsection 163.2(2) and (4) is to be determined under the general rule of whether the person knows, or would have known but for circumstances amounting to culpable conduct, that the statement is a false statement that could be used for a purpose under the Act. If, however, the person's statement as to the value of a property or service is established by Revenue Canada to be outside of the range, in order to avoid liability for the penalty the person who made the statement as to the value is to establish that the stated value was reasonable in the circumstances and that the statement was provided in good faith.

#### ITA

##### 163.2(10) and (11)

New subsection 163.2(10) provides two rules for the purpose of applying the third party civil penalty rules in section 163.2 to a person.

First, paragraph 163.2(10)(a) concerns cases in which a person is assessed a penalty under subsection 163.2(2) at a particular time and another assessment of the penalty is made at a later time. If the penalty is reassessed because the gross entitlements of the person are greater at the subsequent time, the reassessment of the penalty at that later time is considered to be a separate penalty (see new subparagraph 163.2(10)(a)(i)). In any other case, the notice of assessment of the earlier penalty is considered not to have been sent for the purpose of applying section 163.2 (see subparagraph 163.2(10)(a)(ii)). Reference should also be made to paragraph 163.2(10)(b), which deals with the calculation of the gross entitlements for the purpose of that later assessment.

Paragraph 163.2(10)(b) excludes certain amounts from a person's gross entitlements (in respect of a planning or valuation activity in which there is a false statement made or furnished by the person). In general, this rule operates to base each assessment of a penalty under subsection 163.2(2) in respect of a false statement on the gross

entitlements of the person not counted in computing the amount of the person's penalty(ies) previously assessed in respect of the false statement. However, where subparagraph 163.2(10)(a)(ii) applies, paragraph 163.2(10)(b) does not apply to reduce the amount of the second assessment as the original notice of assessment is deemed not to have been sent. Thus the penalty amount on the second assessment in that case is based on the person's total gross entitlements at the time the notice of that assessment is sent.

As an example, suppose a person is assessed a penalty at a particular time under subsection 163.2(2) in the amount of \$10,000, which represents the amount of the person's gross entitlements from a planning activity at that time. At a later time, it is discovered that the person's gross entitlements from the same planning activity have increased to \$25,000 and another assessment of a penalty is made at that later time under subsection 163.2(2) against the person. The effect of subparagraph 163.2(10)(a)(i) in these circumstances is to deem the second assessment to be the assessment of a second penalty, and the effect of paragraph 163.2(10)(b) is to reduce the person's gross entitlements at the later time to \$15,000, in order to take into account the previous assessment of \$10,000. Thus the end result is that the person is liable to pay two penalties, one of \$10,000 as of the particular time and another of \$15,000 as of the later time.

As another example, suppose that the facts are the same as above, except that at the time of the first assessment the person's gross entitlements were \$700. In that case, the person would have been assessed \$1,000 under paragraph 163.2(3)(a) at that time. When the person is assessed at the later time, paragraph 163.2(10)(b) reduces the person's gross entitlements at that later time by \$1,000, the amount of the previous assessment of the penalty. As well, subparagraph 163.2(10)(a)(i) deems the second assessment to be the assessment of a second penalty. In these circumstances, the person would be liable to pay a penalty of \$1,000 as of the particular time and would be liable to pay a second penalty of \$24,000 as of the later time.

Further, new subsection 163.2(11) provides that, if an assessment of a penalty under subsection 163.2(2) or (4) is vacated, the assessment is deemed to be void.

New subsection 163.2(12) provides that a person who is liable to pay a penalty under both subsections 163.2(2) and (4) in respect of the same false statement is required to pay an amount that is not more than the greater of the penalty under subsection (2) and the penalty under subsection (4).

### *Examples*

The application of section 163.2 turns on the facts established in any particular case. The supplementary information in Annex 7 to the 1999 Budget Plan provided two examples of the application of the third party civil penalty provisions, as proposed. The following provides four additional examples in respect of applying the third party penalty rules in new section 163.2 of the Act.

#### *Example 1: No Culpable Conduct*

- *Tax Professional X interprets a tax provision for Client A in a manner that could reduce Client A's tax liability.*
- *The interpretation concerns a matter in which bona fide uncertainty as to the application of the tax law exists, and where Revenue Canada may be expected to disagree with the interpretation.*
- *Tax Professional X, on A's behalf, files the related tax return based on the interpretation.*
- *Revenue Canada subsequently audits and reassesses Client A's tax return vis-à-vis the matter. Eventually the Supreme Court of Canada supports Revenue Canada's interpretation of the matter in respect of Client A's tax return.*
- *On the facts, Tax Professional X is not liable for a penalty under subsection 163.2(2) or (4) in respect of a tax planning arrangement or a tax filing that has a false statement because Tax Professional X did not know the statement was false when made and would not be reasonably expected to know,*



*but for circumstances amounting to culpable conduct, that this was the case.*

**Example 2: Reliance, in good faith**

*- Accountant X is asked by Client A to prepare a tax return including a business financial statement to be used in the return. In response to a request by Accountant X for business related documents, Client A supplies information to Accountant X, which includes a travel expense receipt. Accountant X relies, in good faith, on this information provided by Client A and prepares the business statement that is filed with the return.*

*- Revenue Canada conducts a compliance audit and determines that Client A's travel expense was a non-deductible personal expense.*

*- Accountant X is not liable for participating in an understatement of Client A's tax liability because Accountant X*

- did not know the expense receipt was personal in nature, and*
- would not be reasonably expected to know, but for circumstances amounting to culpable conduct, that this was the case (i.e., this is because X relied in good faith on the information provided by A).*

**Example 3: Indifference as to Whether the Act is Complied With**

*- Accountant X has several clients that have been reassessed in respect of a tax shelter. Accountant X knows that Revenue Canada is challenging the tax effects claimed in respect of the tax shelter on the basis that the shelter is not a business, is based on a significant overvaluation of the related property and, alternatively, is technically deficient.*

*- The Tax Court of Canada, in a test case (formal procedure), denies deductions claimed in respect of the tax shelter in a previous year by Client B (a client of*



*Accountant X). Client B's appeal is dismissed. The case is not appealed and Accountant X is aware of the Court's decision.*

*- Accountant X prepares and files a tax return on behalf of Client C that includes a claim in respect of the same tax shelter that the Tax Court determined was ineffective.*

*- On these facts, Accountant X would be liable for a third party penalty. However, if Accountant X had determined that there was a reasonable basis upon which the Tax Court decision could be overturned by a higher court, the penalty would not apply – see example 1.*

#### ***Example 4: Wilful, Reckless or Wanton Disregard of the Law***

*- Taxpayer Z approaches Tax-preparer X to prepare and e-file Z's tax return. Prior to this, X (and X's firm) did not provide any services to Z and they did not know of each other.*

*- Taxpayer Z provides X with a T4 slip indicating that Z has \$32,000 of employment income.*

*- Taxpayer Z advises X that he made a charitable donation of \$24,000 but forgot the receipt at home. Z asks that X prepare and e-file the tax return. In fact, Z never donated anything to a charity.*

*- On these facts, if X were to prepare and e-file Z's return without obtaining the charitable donation receipt, X would be liable for a third party penalty. Given that the quantum of the deduction is so disproportionate to Z's apparent resources as to defy credibility, to proceed in such a manner would show an indifference as to whether the Act is complied with or would show a wilful, reckless or wanton disregard of the law.*

## **Clause 38**

### **Limitation of Right to Object to Assessments or Determinations**

ITA

165(1.1)(a)

Subsection 165(1.1) of the Act restricts the matters to which a taxpayer may object in certain cases where the Minister of National Revenue has issued a notice of assessment or determination to those matters that gave rise to the assessment or determination. The amendment to paragraph 165(1.1)(a) adds a reference to new subsection 161.1(7) to the list of those provisions for the purposes of which subsection 165(1.1) applies. Subsection 161.1(7) allows the Minister to make consequential assessments of interest and penalties necessary to take into account a reallocation of an overpayment amount on account of an underpayment amount under the interest offset provisions of new section 161.1.

This amendment applies after 1999.

## **Clause 39**

### **Individual Surtax**

ITA

180.1(1)

Section 180.1 of the Act imposes a general surtax on individuals at a rate of 3% of tax payable under Part I. An additional 5% surtax is imposed on that portion of an individual's Part I tax in excess of \$12,500. A surtax reduction (maximum \$250) is provided and is phased out at a rate of 6 per cent of basic federal tax in excess of \$8,333.

The amendments to subsection 180.1(1) eliminate the 3% general surtax starting in 2000. For 1999, the amount of the surtax will be equal to 50% of the amount otherwise determined.

These amendments apply to the 1999 and subsequent taxation years.

**Clause 40****Part VI Tax on Capital of Financial Institutions**

ITA

190.1

Part VI of the Act levies a tax on the taxable capital employed in Canada of financial institutions. In general terms, a financial institution's taxable capital employed in Canada is the amount of its long-term debt, equity and non-deductible reserves that are considered to be used in connection with its activities carried on in Canada.

ITA

190.1(1.2)

Subsection 190.1(1.2) of the Act imposes an additional temporary Part VI tax on the taxable capital employed in Canada of financial institutions, other than life insurance corporations. The additional tax is equal to 0.15 per cent of a corporation's taxable capital employed in Canada in excess of its "enhanced capital deduction" of \$400 million. Where the corporation is related to another financial institution at the end of the year, the enhanced capital deduction must be shared by members of the related group.

The additional tax, which was introduced in the 1995 budget and extended in subsequent budgets, is scheduled to expire on October 31, 1999. This amendment extends the application of the additional tax until October 31, 2000. For taxation years that include October 31, 2000, the additional tax will be prorated on the basis of the number of days in the taxation year that are before November 1, 2000.

This amendment applies to taxation years that end after February 27, 1995.

## **Clauses 41 to 46**

### **Labour-Sponsored Venture Capital Corporations**

ITA

Part X.3

Part X.3 of the Act (sections 204.8 to 204.87) sets out rules governing labour-sponsored venture capital corporations (LSVCCs). Most of these rules apply only to LSVCCs registered under Part X.3, which are referred to in these notes as federally registered LSVCCs.

#### **Subclause 41(1)**

ITA

204.8

Section 204.8 of the Act defines terms for the purposes of the registration of LSVCCs and the application to registered LSVCCs of penalties and taxes under Part X.3.

Existing section 204.8 is renumbered as subsection 204.8(1), as a consequence of the introduction of new subsection 204.8(2). Further amendments to section 204.8 are set out below.

This amendment applies to the 1999 and subsequent taxation years.

#### **Subclause 41(2)**

ITA

204.8(1)

“eligible business entity”

An “eligible business entity” is defined in subsection 204.8(1) of the Act. It includes a Canadian partnership or taxable Canadian corporation, where all or substantially all of the fair market value of the property of the partnership or corporation is property used in a specified active business (as defined in subsection 204.8(1)) carried on in Canada by the entity or a corporation controlled by the entity. A taxable Canadian corporation is also an “eligible business entity” if all or substantially all of the fair market value of its property is

attributable to any combination of shares and debt issued by related eligible business entities. As a consequence of section 204.82 and the definition “eligible investment” in subsection 204.8(1), a federally registered LSVCC must make substantial investments in eligible business entities to avoid liability for penalties under section 204.82.

The definition “eligible business entity” is amended for the 1999 and subsequent taxation years to include a prescribed corporation. For this purpose, it is intended to prescribe corporations registered under Part III.1 of the Ontario *Community Small Business Investment Funds Act* (CSBIFA). These corporations are designed to provide pools of capital to very small businesses.

There are two related amendments under which corporations registered under Part III.1 of the CSBIFA will be likewise prescribed. New clause 204.82(2.2)(d)(i)(B) provides a 50% gross-up to the cost to an LSVCC of an eligible investment in a share issued by a prescribed corporation for the purposes of computing an LSVCC’s investment shortfall. New subsection 204.82(6), in conjunction with existing subsection 204.82(5), provides in every case that a federally registered LSVCC must pay a tax equal to the amount payable by the LSVCC to the government of a province as a consequence of a failure of a prescribed corporation to meet the investment criteria required of it in the particular province. For details on new clause 204.82(2.2)(d)(i)(B) and new subsection 204.82(6), see the commentary below.

### **Subclause 41(3)**

ITA

204.8(1)

“start-up period”

Under existing subsection 204.82(2) of the Act, the penalties on an LSVCC for failing to meet its small business investment requirement are not effective until after its fifth taxation year that ends after the time at which the LSVCC first issues Class A shares. Until that time, penalties are imposed on the LSVCC under subsection 204.82(1) if it fails to hold sufficient amounts in any combination of eligible investments and liquid reserves.



Subsection 204.8(1) is amended to introduce the definition “start-up period”. The penalty under amended subsection 204.82(1) for an LSVCC applies only during its start-up period. The penalty under amended subsection 204.82(2) applies only after its start-up period. The effect of the new definition and the amendments to subsections 204.82(1) and (2) is to shorten the period of time during which subsection 204.82(1) applies to an LSVCC and, correspondingly, lengthen the period of time during which subsection 204.82(2) applies to it. Unless an LSVCC elects otherwise, these amendments will only affect LSVCCs that first issue Class A shares after February 16, 1999.

Subject to the election described below, an LSVCC's “start-up period” is:

- if it first issued Class A shares before February 17, 1999, the taxation year in which the LSVCC first issued those shares and the four following taxation years, and
- in any other case, the taxation year in which it first issues Class A shares and the following taxation year.

An LSVCC may elect to shorten its start-up period by filing an election for a taxation year with its return under Part I for a particular taxation year of the LSVCC that ends after 1998. Where this election is filed with an LSVCC's return for a taxation year, its start-up period will exclude the year and all taxation years following the year. As noted in Example 2 below, this election can result in an LSVCC having no start-up period.

### ***Example 1***

*An LSVCC first issued Class A shares in its 1997 taxation year. The LSVCC files an election in writing with its return under Part I for its 2000 taxation year. As a consequence of the election, its start-up period would consist of its 1997, 1998 and 1999 taxation years.*

### ***Example 2***

*An LSVCC first issues Class A shares on June 1, 1999, which is in its 1999 taxation year. The LSVCC files an election in writing with its return under Part I for its 1999 taxation year. As a consequence of*

*the election, the LSVCC would have no start-up period. Accordingly, the LSVCC would not be subject to subsection 204.82(1) and would be immediately subject to the federal business investment requirement under subsection 204.82(2).*

This new definition applies after 1997.

#### **Subclause 41(4)**

ITA

204.8(2)

New subsection 204.8(2) of the Act sets out the circumstances in which a corporation discontinues its venture capital business for the purposes of section 127.4 and Parts X.3 and XII.5 of the Act. A corporation discontinues its venture capital business:

- at the time its articles cease to comply with paragraph 204.81(1)(c) and would so cease if it had been incorporated after December 5, 1996;
- at the time it begins to wind-up;
- immediately before the time it amalgamates or merges with one or more other corporations to form one corporate entity (other than an entity deemed by continuation rules for amalgamations and mergers in paragraph 204.85(3)(d) to be a registered labour-sponsored venture capital corporation);
- at the time it becomes a revoked corporation, if one of the grounds on which the Minister of National Revenue could revoke its registration for the purposes of Part X.3 is set out in paragraph 204.81(6)(a.1) (generally, where a corporation does not comply with any of the provisions of its articles that are required under paragraph 204.81(1)(c) as a condition for registration); or
- at the first time after the revocation of its registration for the purposes of Part X.3 that it fails to comply with any of the provisions of its articles governing its authorized capital, the management of its business and affairs, the reduction of paid-up capital or the redemption or transfer of its Class A shares.

When a federally registered LSVCC or a revoked corporation first discontinues its venture capital business there are a number of consequences. A new penalty tax is provided in these circumstances under new section 204.841, which, as explained in the commentary below, is designed to recover a portion of the federal tax credits provided under section 127.4 to shareholders of the LSVCC.

In addition:

- the subsequent acquisition of a share of the capital stock of the corporation will not give rise to any entitlement to a tax credit under section 127.4 because of new paragraph (a) of the definition “approved share” in subsection 127.4(1);
- the corporation will cease to become liable to pay tax under subsections 204.82(1), (2) and (6); and
- because of an amendment to subsection 211.8(1), the corporation’s shareholders will not be liable under Part XII.5 of the Act for recovery of the tax credit under section 127.4 in respect of the disposition of a share of the corporation, if the disposition occurs after the corporation discontinues its venture capital business.

This amendment applies after February 16, 1999.

#### ITA 204.8(3)

The application of subsection 211.8(1) of the Act and a number of provisions in Part X.3 depends on the date on which a Class A share issued by an LSVCC is issued or on the date of “original acquisition” of the share. This date can affect the calculation of taxes and penalties under section 204.82 and new section 204.841, as well as the calculation of the recovery tax under subsection 211.8(1).

New subsection 204.8(3) is introduced to clarify this date, in the event that it becomes relevant when Class A shares are disposed of by a person or a corporation discontinues its venture capital business. In determining this date in respect of particular shares, identical Class A shares held by any person are deemed to be disposed of by the person in the order in which the shares were issued.

This amendment applies after February 16, 1999.

## **Clause 42**

### **Labour-Sponsored Venture Capital corporations – Revocation of Registration**

ITA

204.81(6)(g), (8.1) and (8.2)

Subsection 204.81(6) of the Act permits the Minister of National Revenue to revoke the registration under Part X.3 of an LSVCC. The main difference between a federally registered LSVCC and a revoked LSVCC is that shares issued by the revoked LSVCC are not eligible for a tax credit under section 127.4. A revoked LSVCC is still subject, for example, to a liability under section 204.82 and obligations under Part XII.5. The revocation of registration is subject to procedures specified in subsections 204.81(7) and (8).

Paragraph 204.81(6)(g) allows the Minister of National Revenue to revoke the registration of an LSVCC if, at any time in any of its first five taxation years that end after the LSVCC first issues a Class A share, the LSVCC fails to invest specified amounts in eligible investments or liquid reserves.

Paragraph 204.81(6)(g) is repealed, effective from February 16, 1999. The repeal of this measure is intended to simplify the revocation rules and recognizes that there is no longer any period required under amended subsection 204.82(1) during which an LSVCC is required to have a minimum holding of eligible investments and liquid reserves.

New subsection 204.81(8.1) applies where the Minister of National Revenue (MNR) receives a certified copy of a resolution of the directors of an LSVCC seeking the revocation of the LSVCC's registration under Part X.3. Where this occurs, the LSVCC's registration is revoked as of the time the MNR receives the resolution and the MNR must, with all due dispatch, give notice in the *Canada Gazette* of the revocation. Where the directors' resolution is mailed to the MNR, new subsection 204.81(8.2) provides that the date of its receipt is determined without reference to subsection 248(7).



(Subsection 248(7) generally provides that the date of a document's receipt is the date of its mailing.)

New subsections 204.81(8.1) and (8.2) apply to resolutions received by the Minister of National Revenue after Royal Assent.

## **Clauses 43 and 44**

### **Labour-Sponsored Venture Capital Corporations – Recovery of Credit**

ITA

204.82(1) and (2)

Subsection 204.82(1) of the Act levies a tax on a federally registered LSVCC where, at any time in any of its first five taxation years that end after it first issued a Class A share, the LSVCC fails to invest at least 80% of the consideration received by it for the sale of Class A shares before that time (net of amounts paid by the LSVCC to its shareholders before that time as a return of capital on such shares) in eligible investments and liquid reserves. Subsection 204.82(2) imposes a tax on a federally registered LSVCC where, at any time after the fifth taxation year of the LSVCC ending after it first issued Class A shares, it fails to meet a required level of eligible investment. If there is an investment shortfall at any time in a month, the LSVCC is required to pay a tax under subsection 204.82(2) in respect of the month equal to the greatest such shortfall in the month multiplied by 1/60 of the prescribed rate of interest in effect for the month.

Subsection 204.82(1) is amended so that it results in a penalty to an LSVCC for a taxation year only in the event that the year is included in the LSVCC's start-up period. An LSVCC is subject to tax under amended subsection 204.82(2) where, at any time after the end of the LSVCC's start-up period, it fails to meet its investment requirements. For more details, see the commentary on the new definition "start-up period" in subsection 204.8(1).

Subsections 204.82(1) and (2) are also amended so that the taxes imposed by these provisions do not apply to an LSVCC after it first discontinues its venture capital business. For more details on when



an LSVCC discontinues its venture capital business, see the commentary on new subsection 204.8(2).

These amendments apply to the 1999 and subsequent taxation years.

ITA

204.82(2.2)(d)

Subsection 204.82(2.2) of the Act provides rules for computing an LSVCC's investment shortfall for the purpose of determining its liability for tax under subsection 204.82(2). Paragraph 204.82(2.2)(d) is meant to encourage equity investments in smaller businesses by grossing-up, by 50%, the cost of each eligible investment in a qualifying corporation. For this purpose, a corporation qualifies if it and related corporations have a combined total asset cost of not more than \$10 million. The grossed-up cost is relevant for the purpose of calculating an LSVCC's investment shortfall.

New clause 204.82(2.2)(d)(i)(B) extends the 50% gross-up to eligible investments in prescribed corporations. For this purpose, it is intended to prescribe corporations registered under Part III.1 of the Ontario *Community Small Business Investment Funds Act*. These corporations are designed to provide pools of capital to very small businesses.

Paragraph 204.82(2.2)(d) is amended to increase the 50% gross-up to 100% in connection with certain eligible investments in qualifying corporations (other than a prescribed corporation, described above). For the purpose of the 100% enhanced gross-up, a corporation is a qualifying corporation if it and related corporations have a combined total asset cost of no more than \$2.5 million. The purpose of this amendment is to encourage LSVCCs to participate in the early-stage financing of very small businesses.

These amendments apply to the 1999 and subsequent taxation years.

ITA

204.82(6) and 204.83(2)

Subsection 204.82(5) of the Act imposes a tax on an a provincially registered LSVCC that has not been registered under Part X.3 where the LSVCC is liable to pay an amount to the government of a

province as a consequence of a failure to acquire sufficient properties of a character described in the law of the province. Where tax was payable under subsection 204.82(5) by an LSVCC for a taxation year, subsection 204.83(2) provides a refund to the LSVCC where the government of a province refunds to the LSVCC, at any time, an amount that had been paid in satisfaction of a particular amount payable in a taxation year of the LSVCC.

New subsection 204.82(6) of the Act imposes a tax under Part X.3 where a federally registered LSVCC or a revoked corporation is liable to pay an amount to the government of a province as a consequence of a failure of a prescribed corporation to acquire sufficient properties of a character described in the law of the province. For this purpose, it is intended to prescribe corporations registered under Part III.1 of the Ontario *Community Small Business Investment Funds Act*.

The tax payable under subsection 204.82(6) is equal to the amount payable by the LSVCC to the provincial government. The tax is only exigible, however, in respect of amounts that became payable to a provincial government before the LSVCC first discontinues its venture capital business. For further discussion of when an LSVCC discontinues its venture capital business, see the commentary on new subsection 204.8(2).

Subsection 204.83(2) is amended to allow a refund of taxes paid under new subsection 204.82(6). Where a tax was payable by an LSVCC under subsection 204.82(6), an amount will be refunded to the LSVCC where the government of a province refunds to the LSVCC an amount that had been paid in satisfaction of a particular amount payable in a taxation year of the LSVCC.

These amendments apply to the 1999 and subsequent taxation years.

**Clause 45****Penalty Tax Where Venture Capital Business Discontinued**

ITA

204.841

New section 204.841 of the Act imposes a penalty tax on a federally registered LSVCC or a revoked corporation that discontinues its venture capital business. For details of when a corporation discontinues its venture capital business, see the commentary on new subsection 204.8(2).

The penalty tax payable under section 204.841 for a taxation year is designed to approximate a recovery of the federal tax credit under section 127.4. The tax is payable in respect of each Class A share of the capital stock of the corporation that is outstanding immediately before it first discontinues its venture capital business. No tax is payable, however, in respect of outstanding shares held beyond the required holding period of five years in the case of shares the original acquisition of which was before March 6, 1996 and eight years for other shares. Further, the amount of the tax credit recovered for a share in respect of a discontinued venture capital business within a holding period is reduced on a proportional basis for each whole year within the holding period throughout which the share is outstanding. In identifying the holding period associated with a share and the part of that period during which it is outstanding, reference can be made to new subsection 204.8(3) under which identical Class A shares are considered to have been disposed of by a person in the order in which they were issued.

### Example

*A federally registered LSVCC first discontinues its venture capital business on December 1, 1999. Immediately before that time there are two million outstanding Class A shares of the LSVCC, issued on four separate dates. The determination of the amount of tax payable under section 204.841 in respect of each outstanding block of Class A shares is summarized in the following table:*

Description of Class A shares	Resulting tax payable
250,000 shares issued on July 23, 1993 for consideration of \$10.00 per share.	No tax is payable in respect of these shares because they have been held beyond the required holding period of five years in the case of shares issued before March 6, 1996.
650,000 shares issued on April 15, 1995 for consideration of \$10.00 per share.	The tax payable in respect of these shares is \$260,000 $((650,000 \times \$10 \times 4\%) \times 1)$ .
750,000 shares issued on February 7, 1996 for consideration of \$8.00 per share.	The tax payable in respect of these shares is \$480,000 $((750,000 \times \$8 \times 4\%) \times 2)$ .
350,000 shares issued on December 23, 1998 for consideration of \$7.50 per share.	The tax payable in respect of these shares is \$393,750 $((350,000 \times \$7.50 \times 1.875\%) \times 8)$ .

This amendment applies to businesses that are discontinued after February 16, 1999.

**Clause 46****Labour-Sponsored Venture Capital Corporations – Dissolutions, etc.**

ITA

204.85(1)

Subsection 204.85(1) of the Act provides that a federally registered LSVCC or a revoked corporation may not merge or amalgamate with another corporation, liquidate or dissolve without the written permission of the Minister of Finance, if the corporation has issued Class A shares. The Minister of Finance is provided with the authority to impose terms and conditions upon a transaction to which the provision applies.

Subsection 204.85(1) is amended to remove the requirement of the written consent of the Minister of Finance to a transaction to which subsection 204.85(1) applies. The Minister of Finance's power to impose terms and conditions on such transactions is also removed. Instead, a federally registered LSVCC or revoked corporation that has issued any Class A shares shall send written notification of any proposed amalgamation, merger, liquidation or dissolution of the corporation to the Minister of National Revenue (rather than the Minister of Finance) at least 30 days before the amalgamation, merger, liquidation or dissolution, as the case may be.

This amendment applies to amalgamations, mergers, dissolutions and liquidations that occur more than 30 days after Royal Assent.

ITA

204.85(3)

New subsection 204.85(3) of the Act applies, for the purposes of section 127.4 and Parts X.3 and XII.5, where there is an amalgamation or merger of corporations at least one of which is a federally registered LSVCC or a revoked corporation. For these purposes, the new corporation is generally treated under paragraph 204.85(3)(a) as if it were the same corporation as, and a continuation of, each predecessor corporation.



Paragraph 204.85(3)(b) applies where a predecessor corporation was authorized to issue a class of shares to which clause 204.81(1)(c)(ii)(C) applied. In this case, the new corporation is deemed to have received approval from the Minister of Finance to issue substantially similar shares at the time of the amalgamation or merger. Paragraph 204.85(3)(b) ensures that an LSVCC's status as a registered LSVCC is not lost on an amalgamation or merger simply because such shares are issued without the prior approval of the Minister of Finance.

Paragraph 204.85(3)(c) provides that shares issued by the new corporation in satisfaction of shares issued by a predecessor corporation are deemed not to have been issued on the amalgamation or merger. Instead, the new shares are considered to have been issued at the time the replaced shares were issued. This measure ensures that shares held more than five years or eight years, as the case may be, are appropriately factored under paragraph 204.82(2.2)(c.1) into the computation of the investment shortfall of a registered LSVCC.

Under new paragraph 204.85(3)(d), the Minister of National Revenue is deemed to have registered the new corporation for the purpose of Part X.3 unless

- the new corporation is not governed by the *Canada Business Corporations Act*,
- one or more of the predecessor corporations was a federally registered LSVCC the venture capital business of which was discontinued before the merger or amalgamation,
- one or more of the predecessor corporations was, immediately before the amalgamation or merger, a revoked corporation,
- immediately after the amalgamation or merger, the articles of the new corporation do not comply with paragraph 204.81(1)(c), or
- shares other than Class A shares of the capital stock of the new corporation were issued to any shareholder of the new corporation in satisfaction of any share (other than a share to which clause 204.81(1)(c)(ii)(B) or (C) applied) of a predecessor corporation.

Where paragraph 204.85(3)(d) does not apply, the new corporation is deemed by paragraph 204.85(3)(e) to be a revoked corporation.

Paragraphs 204.85(3)(f) and (g) deal with the application of the penalty taxes under subsections 204.82(1) and (2). Amended subsection 204.82(1) imposes a penalty tax for each taxation year in the LSVCC's start-up period to the extent that the LSVCC does not have a sufficiently high combination of eligible investments and liquid reserves. Amended subsection 204.82(2) imposes a penalty tax with regard to investment shortfalls in small business investment only after the LSVCC's start-up period. Paragraphs 204.85(3)(f) and (g) provide that subsection 204.82(2) applies to each taxation year of the new corporation and that subsection 204.82(1) does not apply at all.

This amendment applies to amalgamations and mergers that occur after February 16, 1999.

## **Clause 47**

### **Foreign Property Tax**

ITA  
206(1)

“small business investment amount”

“small business property”

Part XI of the Act (sections 205 to 207) subjects certain persons described in paragraphs 205(a) to (f), such as a trust governed by a registered pension plan (RPP), registered retirement savings plan (RRSP) or registered retirement income fund (RRIF), to tax under Part XI if they invest too heavily in “foreign property” (as defined in subsection 206(1)). The regular foreign property limit for a person is 20% of the total cost amount of the person's assets.

Paragraph 206(2)(c) currently permits these persons to hold \$3 of additional foreign property for a particular month for every \$1 of the person's average total cost amount of “small business properties” (as defined in subsection 206(1)) over the three preceding months. This three-month average cost is defined in subsection 206(1) as the “small business investment amount”. The additional foreign property room

for a person cannot exceed an extra 20% of the total cost amount of the person's property. Under paragraph (f) of the definition "small business property", a property generally qualifies as such to a person only if the person is the first purchaser (other than a broker or dealer in securities) of the property.

The definition "small business investment amount" is amended so that a person's "small business investment amount" at any time is, in all cases, no less than the person's total cost amount of small business properties at the end of the month. This amendment is intended to accelerate access to additional foreign property room after the acquisition of small business properties.

Paragraph (f) of the definition "small business property" is amended so that a trust governed by an RRSP or RRIF need not be the first person (other than a broker or dealer in securities) to acquire a property in order for the property to qualify as the trust's "small business property". This measure applies if the first person to acquire the property was the annuitant under the RRSP or RRIF trust, the spouse or former spouse of that annuitant or an RRSP or RRIF trust under which any of those individuals was the annuitant. Moreover, for this measure to apply as of any time, the property must (after it was first acquired otherwise than by a broker or dealer in securities) have been held continuously by the persons described above. This relieving amendment is intended to prevent the loss of additional foreign property room under the "3 for 1" rule, in connection with common types of transfers within non-arm's length groups.

These amendments apply to months that end after 1997.

## **Clauses 48 to 50**

### **Recovery of Labour-Sponsored Funds Tax Credit**

Part XII.5 of the Act (sections 211.7 to 211.9) provides for a special tax that is designed to recover the federal tax credit under section 127.4 of the Act with respect to the original acquisition of a share issued by an LSVCC. The special tax applies where there is a disposition of an "approved share" (as defined in subsection 127.4(1)).

ITA  
211.7

Existing section 211.7 is renumbered as subsection 211.7(1), as a consequence of the introduction of new subsection 211.7(2).

New subsection 211.7(2) deems, for the purposes of Part XII.5, there to be no redemption, acquisition or cancellation of shares by a predecessor corporation on the amalgamation or merger of a predecessor corporation to form a corporate entity that is deemed by paragraph 204.85(3)(d) to be a registered labour-sponsored venture capital corporation. In these circumstances, there is no recovery under Part XII.5 of the federal tax credit under section 127.4 with respect to the shares of the predecessor corporation.

These amendments apply after February 16, 1999.

ITA  
211.8(1) and (1.1)

Subsection 211.8(1) of the Act is amended so that there is no Part XII.5 tax in respect of the disposition of a share issued by a corporation, if the disposition occurs at or after the time that the corporation first discontinues its venture capital business. For details of when a corporation discontinues its venture capital business and the consequences for the corporation, see the commentary on new subsection 204.8(2) and section 204.841.

Subsection 211.8(1.1) of the Act is introduced so that the continuation rules for amalgamations and mergers in Part X.3 (new subsection 204.85(3)) also apply for the purposes of subsection 211.8(1). Subsection 211.8(1.1) also provides that further new rules of application in Part X.3 (subsection 204.8(2), determining when an LSVCC discontinues its venture capital business, and subsection 204.82(3), determining the order of disposition of Class A shares) also apply for the purpose of subsection 211.8(1). For further detail in this regard, see the commentary above on these new provisions in Part X.3.

The amendments to section 211.8 apply to redemptions, acquisitions, cancellations and dispositions that occur after February 16, 1999.



## ITA 211.9

Section 211.9 of the Act authorizes the Minister of National Revenue to provide a refund to an individual where an amount has been paid under Part XII.5 of the Act or former section 6706 of the Regulations. The amount that may be refunded cannot exceed the lesser of the amount so paid and a specified amount minus the amount deducted in respect of the original acquisition of the share by the individual under subsection 127.4(2). The individual must request the refund in a written application filed with the Minister no later than 2 years after the end of the calendar year in which the disposition occurred.

Section 211.9 is amended to provide that the amount deducted in respect of the original acquisition of an LSVCC share by the individual under subsection 127.4(2) is no longer subtracted from the specified amount in determining the maximum possible refund under the provision. This amendment is not intended to indicate any change in the policy underlying section 211.9, but does reflect the identical nature of any given class of shares and the manner in which the amount deducted under subsection 127.4(2) is calculated. In many cases, it is impossible to allocate the amount deducted under subsection 127.4(2) to specific shares. Instead, the Minister will be expected to use reasonable assumptions in determining how much of the tax under Part XII.5 should be refunded. The exercise of the Minister's discretion in this regard is illustrated in the example below.

### ***Example***

*An individual acquires \$5,000 of LSVCC shares in April 1999. The individual's tax otherwise payable for the 1999 taxation year is \$450 and the individual therefore claims a \$450 deduction under subsection 127.4(2) as an LSVCC tax credit for 1999. Subsequently, one half of the shares are redeemed for \$2,800 in July 2000, but the LSVCC withholds \$375 ( $\$2,500 \times 15\%$ ) under Part XII.5 as a recovery of the LSVCC tax credit.*

*In these circumstances, it would be reasonable to view the individual as having acquired \$2,000 of "extra" LSVCC shares (i.e., acquisitions that cannot increase the LSVCC tax credit deducted) that are subsequently redeemed. As a consequence, it is generally*



*expected that the Minister would permit a recovery of Part XII.5 tax of up to \$300 (\$2,000 x 15%).*

These amendments apply to dispositions that occur after 1998.

## **Clause 51**

### **Penalty on Conviction**

ITA

239(3)

Subsection 239(3) of the Act protects a person convicted of an offence under section 239 from being later subject to a civil penalty under sections 162 or 163 or under subsection 239(1.1) of the Act. Subsection 239(3) is amended to apply to a person who is subject to a penalty under the third party penalty rules under new section 163.2 of the Act.

## **Clause 52**

### **Definitions**

ITA

248

Section 248 of the Act defines a number of terms that apply for the purposes of the Act and sets out various rules relating to the interpretation and application of various provisions of the Act.

Subsection 248(1) is amended to introduce two definitions that are relevant for new section 120.4 of the Act, which provides for a separate tax on split income, and are used elsewhere in the Act. Those definitions are “specified individual” and “split income”. The substantive definitions for those expressions are found in subsection 120.4(1).

For information on the tax on split income, see the commentary on new section 120.4.

These amendments apply to the 2000 and subsequent taxation years.

## **Compound Interest**

ITA  
248(11)

Subsection 248(11) of the Act provides that interest computed at a prescribed rate under certain provisions of the Act is to be compounded on a daily basis. A reference is added in this subsection to new subsection 161.1(5), which deals with reversed refunds in the context of the corporate interest offset provisions.

For information on the corporate interest offset provisions, see the commentary on new section 161.1

This amendment applies after 1999.

## **Clause 53**

### **Person Deemed Resident**

ITA  
250(1)(f)

Under paragraph 250(1)(f) of the Act, children who are dependent on certain persons deemed to be resident in Canada, and whose incomes do not exceed the amount of income that can be earned on a tax-free basis, are also deemed to be Canadian residents.

As a consequence of the increase from \$6,456 to \$7,131 of the basic personal amount and the two-year phase-out of the \$500 supplementary amount, the income threshold in paragraph 250(1)(f) is increased to \$7,044 for 1999 and to \$7,131 (partially indexed) starting in 2000.

For information on the changes to the personal amounts, see the commentary on subsection 118(1) of the Act.

This amendment applies to the 1999 and subsequent taxation years.

## Clause 54

### Extended Meaning of “Spouse” and “Former Spouse”

ITA  
252(3)

Subsection 252(3) of the Act extends the meaning of the terms “spouse” and “former spouse” to include, for a number of purposes, a party to a void or voidable marriage. The provision is amended to also apply for the purposes of the amended definition “small business property” in subsection 206(1). For details on the amended definition “small business property”, see the commentary on subsection 206(1).

This amendment applies to the 1998 and subsequent taxation years.

## Clause 55

### Misrepresentation of a Tax Matter by a Third Party

ETA  
285.1

New section 285.1 of the *Excise Tax Act* (ETA) sets out the rules that apply for the purpose of applying civil penalties to third parties that make, or participate in the making of, false statements or omissions in relation to tax matters. This provision parallels new section 163.2 of the *Income Tax Act* (ITA) enacted under clause 37 (see the commentary on that clause).

New section 285.1 comes into force on Royal Assent.

ETA  
285.1(1)

New subsection 285.1(1) provides definitions that apply for the purpose of new section 285.1. The terms defined for this purpose are “culpable conduct”, “entity”, “false statement”, “gross entitlements”, “participates”, “planning activity”, “property”, “subordinate”, and “valuation activity”. Below is more detailed commentary on some of these definitions.

“Culpable conduct” has the same meaning as in new subsection 163.2(1) of the ITA, with the exception of the reference to Part IX of the ETA. In new section 285.1 of the ETA, “culpable conduct” means conduct, whether an act or a failure to act, that

(a) is tantamount to intentional conduct,

(b) shows an indifference as to whether Part IX of the ETA is complied with, or

(c) shows a wilful, a reckless or a wanton disregard of the law.

“False statement” includes a statement that is misleading because of an omission from the statement. The meaning of a “false statement” is also modified in certain cases to deem two or more false statements to be one false statement (see the commentary on new subsection 285.1(7) of the Act).

“Gross entitlements” of a person at any time, in respect of a planning activity or a valuation activity of the person, means all amounts to which the person (or another person not dealing at arm’s length with the person) is entitled, either before or after that time and either absolutely or contingently, to receive or obtain. The definition “gross entitlements” is relevant for the purpose of computing a penalty under new subsection 285.1(2) for making or furnishing a false statement in respect of tax planning arrangements. Reference should also be made to new paragraph 285.1(10)(b), which provides special rules that may apply in particular circumstances to exclude certain amounts from a person’s gross entitlements in respect of a planning activity or a valuation activity.

Generally, “planning activity” includes organizing or creating an entity, plan, scheme or arrangement. It also includes participating (directly or indirectly) in the selling of an interest in, or the promotion of, an entity, plan, scheme or arrangement.

“Valuation activity” of a person means anything done by the person in determining the value of a property or a service.

“Property” is defined for the purposes of new section 285.1 to include money, which is expressly excluded from the general definition of “property” in subsection 123(1) of the ETA.

#### ETA

##### 285.1(2) and (3)

New subsection 285.1(2) provides for a penalty where a person makes or furnishes, or causes another person to make or furnish, a statement that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct, is a false statement that could be used by another person for a purpose of Part IX of the ETA. The amount of the penalty is determined under new subsection 285.1(3).

Subsection 285.1(3) provides that the penalty to which a person is liable under subsection 285.1(2) in respect of a false statement is one of two amounts. The first amount applies where a false statement is made in the course of a planning activity or a valuation activity, and is the greater of \$1,000 and the total of the person’s gross entitlements in respect of the planning activity and the valuation activity calculated at the time at which notice of assessment of the penalty is sent to the person. In certain cases, the computation of a person’s gross entitlements may be in respect of two or more false statements deemed to be one false statement (see the commentary on new subsection 285.1(7) of the Act).

The second amount is \$1,000, which applies in any other case.

#### ETA

##### 285.1(4) and (5)

New subsection 285.1(4) provides for a penalty where a person makes (or participates in, assents to or acquiesces in the making of) a statement to, or by or on behalf of, another person that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct, is a false statement that could be used by or on behalf of the other person for a purpose of Part IX of the ETA. The amount of the penalty is determined under new subsection 285.1(5).



New subsection 285.1(5) provides that the penalty to which a person is liable under subsection 285.1(4) in respect of a false statement is the greater of two amounts. The first amount is \$1,000. The second amount is 50% of the total of the understatement of net tax (or overstatement of a net tax refund) of the other person and tax payable avoided by the other person because of the false statement, and the amount of any excess rebate claimed by the other person on the basis of the false statement.

ETA

285.1(6)

New subsection 285.1(6) provides an exception for reliance in good faith, which applies for the purpose of applying the penalty provision in subsection 285.1(2) (other than in respect of a statement made in the course of a planning activity or a valuation activity) and for the purpose of applying the penalty provision in subsection 285.1(4). This exception provides that a person is not considered to have acted in circumstances amounting to culpable conduct by reason only of having relied, in good faith, on information provided to the person by the other person (see subsections 285.1(2) and (4)) or, because of such reliance, failed to verify, investigate or correct the information.

ETA

285.1(7)

New subsection 285.1(7) provides two rules. First, if applicable, paragraph 285.1(7)(a) treats two or more false statements made or furnished by a person in the course of one or more planning activities (or a valuation activity) as one false statement for the purpose of applying the penalty in subsection 285.1(2) in respect of the person's false statements. This is the case where a person's false statements were made or furnished in the course of one or more planning activities that are in respect of a particular entity, plan, scheme, or arrangement or in the course of a valuation activity that is in respect of a particular property or service.

Second, a person is not considered to have participated in a planning activity or a valuation activity solely because the person provided clerical or secretarial services with respect to the activity.

## ETA

## 285.1(8) and (9)

New subsection 285.1(8) provides a special rule that applies to a false statement, as to the value of a property or service, made by a person who opines on the value of the property or service, or by a person engaged in a planning activity that is the selling of an interest in (or the promotion of) an entity, plan, scheme or arrangement. A statement as to the value of a property or service is considered to be a statement that the person would reasonably be expected to know, but for circumstances amounting to culpable conduct, is a false statement if the stated value is

- less than the prescribed percentage for the property or service multiplied by the fair market value of the property or service, or
- greater than the prescribed percentage for the property or service multiplied by the fair market value of the property or service.

These two parameters provide a range in value outside of which this “reverse onus” rule will apply.

This reverse onus rule applies only where Revenue Canada establishes that the stated value of a property or service is outside of the range. Further, new subsection 285.1(9) provides that subsection 285.1(8) does not apply to a person in respect of a statement as to a value if the person establishes that the stated value was reasonable in the circumstances and that the statement was provided in good faith.

In summary, where a person’s statement as to the value of a property or service is within the range, the liability for a penalty under subsection 285.1(2) and (4) is to be determined under the general rule of whether the person knows, or would have known but for circumstances amounting to culpable conduct, that the statement is a false statement that could be used for a purpose under Part IX of the ETA. If, however, the person’s statement as to the value of a property or service is established by Revenue Canada to be outside of the range, in order to avoid liability for the penalty the person who made the statement as to the value is to establish that the stated value was reasonable in the circumstances and that the statement was provided in good faith.

## ETA

## 285.1(10) and (11)

New subsection 285.1(10) provides two rules for the purpose of applying the third party civil penalty rules in section 285.1 to a person.

First, paragraph 285.1(10)(a) concerns cases in which a person is assessed a penalty under subsection 285.1(2) at a particular time and another assessment of the penalty is made at a later time. If the penalty is reassessed because the gross entitlements of the person are greater at the subsequent time, the reassessment of the penalty at that later time is considered to be a separate penalty (see new subparagraph 285.1(10)(a)(i)). In any other case, the notice of assessment of the earlier penalty is considered not to have been sent for the purpose of applying section 285.1 (see subparagraph 285.1(10)(a)(ii)). Reference should also be made to paragraph 285.1(10)(b), which deals with the calculation of the gross entitlements for the purpose of that later assessment.

Paragraph 285.1(10)(b) excludes certain amounts from a person's gross entitlements (in respect of a planning or valuation activity in which there is a false statement made or furnished by the person). In general, this rule operates to base each assessment of a penalty under subsection 285.1(2) in respect of a false statement on the gross entitlements of the person not counted in computing the amount of the person's penalty(ies) previously assessed in respect of the false statement. However, where subparagraph 285.1(10)(a)(ii) applies, paragraph 285.1(10)(b) does not apply to reduce the amount of the second assessment as the original notice of assessment is deemed not to have been sent. Thus the penalty amount on the second assessment in that case is based on the person's total gross entitlements at the time the notice of that assessment is sent.

As an example, suppose a person is assessed a penalty at a particular time under subsection 285.1(2) in the amount of \$10,000, which represents the amount of the person's gross entitlements from a planning activity at that time. At a later time, it is discovered that the person's gross entitlements from the same planning activity have increased to \$25,000 and another assessment of the penalty is made at that later time under subsection 285.1(2) against the person. The effect of subparagraph 285.1(10)(a)(i) in these circumstances is to

deem the second assessment to be an assessment of a second penalty, and the effect of paragraph 285.1(10)(b) is to reduce the person's gross entitlements at the later time to \$15,000, in order to take into account the previous assessment of \$10,000. Thus the end result is that the person is liable to pay two penalties, one of \$10,000 as of the particular time and another of \$15,000 as of the later time.

As another example, suppose that the facts are the same as above, except that at the time of the first assessment the person's gross entitlements were \$700. In that case, the person would have been assessed \$1,000 under paragraph 285.1(3)(a) at that time. When the person is assessed at the later time, paragraph 285.1(10)(b) reduces the person's gross entitlements at that later time by \$1,000, the amount of the previous assessment of the penalty. As well, subparagraph 285.1(10)(a)(i) deems the second assessment to be the assessment of a second penalty. In these circumstances, the person would be liable to pay a penalty of \$1,000 as of the particular time and would be liable to pay a second penalty of \$24,000 as of the later time.

Further, new subsection 285.1(11) provides that, if an assessment of a penalty under subsection 285.1(2) or (4) is vacated, the assessment is deemed to be void.

ETA

285.1(12)

New subsection 285.1(12) provides that a person who is liable to pay a penalty under both subsections 285.1(2) and (4) in respect of the same false statement is required to pay an amount that is not more than the greater of the penalty under subsection (2) and the penalty under subsection (4).



## Clause 56

### Penalty on Conviction

ETA

327(3)

Subsection 327(3) of the ETA protects a person convicted of an offence under section 327 from being later subject to a civil penalty under section 284 (failure to provide information). Proposed amendments included in Bill C-88, introduced in June 1999, extend this protection to penalties under section 283 or under section 285 (see the commentary on subclause 87(2) of that Bill, and on clause 58 below). Subsection 327(3) is further amended to extend that protection to a person subject to a penalty under the third party penalty rules under new section 285.1.

## Clause 57

### Canada Child Tax Benefit

S.C., 1999, c.26, subsection 36(7)

The *Budget Implementation Act, 1999* contained an amendment to the *Income Tax Act* that provided for a \$350 increase of the National Child Benefit supplement to the Canada Child Tax Benefit payable for each eligible child. This increase is implemented in two steps: \$180 effective July 1999 and an additional \$170 effective July 2000. However, the coming-into-force provision for the amendment did not reflect the two-year phase-in of the increase for families with only one eligible child. This amendment corrects that oversight.

This amendment is deemed to have come into force on June 17, 1999, the day on which the *Budget Implementation Act, 1999* received Royal Assent.



**Clause 58****Conditional Amendment – Penalty on Conviction**

ETA

327(3)

This clause contains an amendment that is conditional on the assent of Bill C-88, introduced in the first session of the thirty-sixth Parliament and entitled *An Act to amend the Excise Tax Act, a related Act, the Cultural Property Export and Import Act, the Customs Act, the Excise Act, the Income Tax Act and the Tax Court of Canada Act*. Subclause 87(2) of that Bill amends subsection 327(3) of the *Excise Tax Act* (ETA) to refer to sections 283 to 285 of the ETA. However, clause 56 also amends that subsection to refer to sections 283 to 285.1. Therefore, if clause 56 comes into force before subclause 87(2) of that Bill, that subclause will be unnecessary and is, in that event, repealed.



